Select Committee on Pension Policy

P.O. Box 40914
Olympia, WA 98504-0914
actuary_st@leg.wa.gov

August 17, 2004

10:00 AM - 1:00 PM

Senate Hearing Room 4
Olympia, Washington

AGENDA

10 AM	**(1)**	**SCPP Rules of Procedure** – Laura Harper, Senior Research Analyst Legal
10:30 AM	**(2)**	**Gain-sharing** – Laura Harper
11:15 AM	**(3)**	**Purchasing Power – Options** – Bob Baker, Senior Research Analyst
Noon	**(4)**	**Pension Funding Council Audit and Recommendations** – Matt Smith, State Actuary
1:00 PM	**(5)**	**Adjourn**

Persons with disabilities needing auxiliary aids or services for purposes of attending or participating in Select Committee on Pension Policy meetings should call (360) 753-9144. TDD 1-800-635-9993

(360) 753-9144
Fax: (360) 586-8135
TDD: 1-800-635-9993

Select Committee on Pension Policy

Meeting and Issue Schedule

(July 16, 2004)

April 20, 2004
10:00 AM - 12:30 PM
Senate Hearing Rm 4

Election of Officers
Session Update
Interim Work Plan
Meeting Dates

May 18, 2004
9:30 AM - 4:00 PM
Senate Hearing Rm 4

Orientation

June 15, 2004
10:00 AM - 12:30 PM
Senate Hearing Rm 4

Adequacy of Benefit
Military Service Credit

July 13, 2004
10 AM - 1 PM
Senate Hearing Room 4

Election of Chair
Adoption of Meeting Schedule
Purchasing Power
Post-Retirement Employment
Contribution Rate Setting

August 17, 2004
10 AM - 1 PM
Senate Hearing Room 4

Rules of Procedure
Purchasing Power - Options
Gain-sharing
PFC Audit and Recommendations

September 7, 2004
10 AM - 1 PM
Senate Hearing Room 4

Age 65 Retirement
Retiree Health Insurance

October 19, 2004
10 AM - 1 PM
Senate Hearing Room 4

Age 65 Retirement - Options
LEOFF 1 Issues

November 9, 2004
10 AM - 1 PM
Senate Hearing Room 4

Plan 3 Vesting
Part-Time ESAs
Technical Corrections

December 7, 2004
10 AM - 1 PM
Senate Hearing Room 4

Legislation

Select Committee on Pension Policy

P.O. Box 40914
Olympia, WA 98504-0914
actuary_st@leg.wa.gov

DRAFT MINUTES

July 13, 2004

The Select Committee on Pension Policy met in Senate Hearing Room 4, Olympia, Washington on July 13, 2004.

Committee members attending:

Senator Fraser, Chair	Representative Fromhold
Representative Conway, Vice-Chair	Robert Keller
Elaine Banks	Glenn Olson
Senator Carlson	Senator Regala
Representative Crouse	J. Pat Thompson
Richard Ford	David Westberg

Senator Fraser called the meeting to order at 10:05 AM.

Senator Fraser asked the committee members to introduce themselves.

1. **Election of Chair**

   Senator Carlson nominated Senator Fraser as Chair of the Select Committee on Pension Policy. Seconded.

   MOTION CARRIED

2. **Adoption of Interim Meeting Schedule**

   It was moved to approve September 7, October 19, November 9, and December 7 as the Select Committee on Pension Policy interim meeting schedule. Seconded

   MOTION CARRIED

3. **Purchasing Power**

   Bob Baker, Senior Research Analyst, presented the report entitled "Purchasing Power."

4. **Post-retirement Employment**

   Laura Harper, Senior Research Analyst Legal, presented the "Post-retirement Employment" report.

(360) 753-9144
Fax: (360) 586-8135
TDD: 1-800-635-9993

5. Contribution Rate-setting

Matt Smith, State Actuary, presented the "Contribution Rate-setting" report.

The following person testified:
Harvey Erickson, Washington Association of School Business Officials

Senator Fraser announced that the Adoption of the Rules of Procedure will be held over to the August 17th meeting.

The meeting adjourned at 1:10 PM.

Select Committee on Pension Policy

Draft Revisions to Rules of Procedure

RULE 1. Membership. The Committee shall consist of 20 members: two from each caucus of the legislature, four active members or representatives of active members of the state retirement systems, two retired members or representatives of retired members of the state retirement systems, four employer representatives, and the Directors of the Department of Retirement Systems and the Office of Financial Management.

The Directors of the Department of Retirement Systems and the Office of Financial Management may appoint alternates from their respective agencies for membership on the SCPP.

RULE 2. Meetings. The Select Committee on Pension Policy (SCPP) will typically meet once each month during the Legislative Interim. Additional meetings may be called by the Chair of the SCPP or Executive Committee as deemed necessary.

RULE 3. Rules of Order. All meetings of the SCPP, its Executive Committee, or any subcommittee created by the SCPP shall be governed by Reed's Parliamentary Rules, except as specified by applicable law or these Rules of Procedure.

RULE 4. Quorum. A majority of the 20 committee members shall constitute a quorum of the Full Committee (11 members). A majority of the members appointed to a subcommittee shall constitute a quorum of the subcommittee.

RULE 5. Voting. A majority of the 20 committee members must vote in the affirmative for an official action of the SCPP to be valid (11 members), a majority of those committee members present must vote in the affirmative on procedural matters (at least 6 members), unless provided otherwise in statute or these Rules of Procedure. A majority of the members appointed to a subcommittee must vote in the affirmative for an official action of a subcommittee to be valid; a majority of those subcommittee members present must vote in the affirmative on procedural matters, unless provided otherwise in statute or these Rules of Procedure.

RULE 6. Minutes. Minutes summarizing the proceedings of each SCPP meeting and subcommittee shall be kept. These minutes will include member attendance, official actions taken at each meeting, and persons testifying.

RULE 7. <u>SCPP Chair, Vice Chair, Executive Committee and Subcommittees</u>. An Executive Committee shall be established and shall include five members. Reorganization elections shall take place at the first meeting of the year as follows: First the Chair shall be elected and then the Vice Chair shall be elected. The Chair shall be a member of the Senate in even-numbered years and a member of the House of Representatives in odd-numbered years. The Vice Chair shall be a member of the House in even-numbered years and a member of the Senate in odd-numbered years.

Two members of the Executive Committee shall then be elected, one member representing active members and one member representing employers. In addition, the Director of the Department of Retirement Systems and the Director of the Office of Financial Management shall alternate membership on the Executive Committee. The Director of the Department of Retirement Systems will serve on the Executive Committee in odd-numbered years; the Director of the Office of Financial Management in even-numbered years.

Executive Committee members may designate an alternate to attend Executive Committee meetings in the event they cannot attend. Alternates shall be members of the SCPP who represent the same member group as the elected Executive Committee member.

Subcommittees of the SCPP may be formed upon recommendation of the Executive Committee. The creation of the subcommittee and appointment of members shall be voted on by the full SCPP.

RULE 8. <u>Duties of Officers</u>.

A. The Chair shall preside at all meetings of the SCPP and Executive Committee, except that the Vice Chair shall preside when the Chair is not present. In their absence, an Executive Committee member may preside.

B. The State Actuary shall prepare and maintain a record of the proceedings of all meetings of the SCPP Committee, Executive Committee, and SCPP Subcommittees.

C. The Executive Committee shall perform all duties assigned to it by these Rules of Procedure, such other duties delegated to it by the SCPP, and shall set meeting agendas and recommend actions to be taken by the SCPP.

D. A recommendation to refer an issue to the Assistant Attorney General will be approved by the Chair or by a majority vote of the Executive Committee. The Chair or the Committee will consider priorities of the SCPP of all legal issues and budget constraints in making this decision.

Advice from the Attorney General's Office to the Chair or the Committee may be subject to the attorney client privilege. When subject to the privilege, Committee members are advised to maintain the advice as confidential. The privilege may be waived only by vote of the Committee.

E. The State Actuary may refer requests for information or services by Select Committee on Pension Policy members that are directly related to current Committee projects or proposals and/or require a significant use of OSA resources to either the Chair of the SCPP or the Executive Committee. Such requests will be approved by either the Chair or by a majority vote of the Executive Committee prior to initiation and completion by the OSA. The Executive Committee will consider priorities of all current OSA projects and budget constraints in making this decision.

F. The State Actuary shall submit the following to the Executive Committee for approval: the biennial budget submission for the OSA, and any personal services contract of $20,000 or more that is not described in the biennial budget submission.

G. The Chair and Vice Chair shall appoint four members of the SCPP to serve on the State Actuary Appointment Committee. At lease one member shall represent state retirement systems' active or retired members, and one member shall represent state retirement system employers. The Chair and Vice Chair may designate an alternate for each appointee from the same category of membership.

RULE 9. Expenses. Legislators' travel expenses shall be paid by the member's legislative body; state employees' expenses shall be paid by their employing agency; other SCPP members' travel expenses shall be reimbursed by the Office of the State Actuary in accordance with RCW 43.03.050 and 43.03.060.

RULE 10. Staff. The OSA shall provide staff and technical assistance to the Committee. The State Actuary has the statutory authority to select and employ such research, technical, clerical personnel, and consultants as the State Actuary deems necessary. The State Actuary shall inform the Executive Committee of final personnel actions. Any employee terminated by the State Actuary shall have the right of appeal to the Executive Committee. The State Actuary has also implemented a grievance procedure within the OSA. Any employee who has followed the OSA grievance process and disagrees with the outcome may appeal to the Chair or Vice Chair for action by the Executive Committee.

Adopted August 17, 2004 by the Select Committee on Pension Policy.

Senator Karen Fraser, Chair	**Representative Steve Conway, Vice Chair**

O:\SCPP\2004\8-17-04 Full\Draft SCPP Rules of Procedure.wpd

Select Committee on Pension Policy

P.O. Box 40914
Olympia, WA 98504-0914
actuary_st@leg.wa.gov

June 25, 2004

State Actuary Appointment Committee Members:

Senator Joseph Zarelli, Chair, Ways and Means Committee
Senator Margarita Prentice, Ranking Minority, Ways and Means Committee
Representative Helen Sommers, Chair, Appropriations Committee
Representative Barry Sehlin, Ranking Minority, Appropriations Committee

Dear Members:

We have appointed the following members of the Select Committee on Pension Policy (SCPP) to the State Actuary Appointment Committee in accordance with Section 13(1)(b), Chapter 295, Laws of 2003.

Chair, SCPP: Senator Shirley Winsley (Senator Karen Fraser effective July 13)
Vice Chair, SCPP: Representative Steve Conway
Richard Ford, representing Retirees
Leland Goeke, representing Employers

Sincerely,

Senator Shirley Winsley	Representative Steve Conway
Chair	Vice Chair

cc: Senator Karen Fraser
Richard Ford
Leland Goeke

O:\SCPP\2004\6-15-04 Exec\State Actuary Appointment Committee appt. letter.wpd

(360) 753-9144
Fax: (360) 586-8135
TDD: 1-800-635-9993

Select Committee on Pension Policy

Rules of Procedure

RULE 1. Membership. The Committee shall consist of 20 members: two from each caucus of the legislature, four active members or representatives of active members of the state retirement systems, two retired members or representatives of retired members of the state retirement systems, four employer representatives, and the Directors of the Department of Retirement Systems and the Office of Financial Management.

The Directors of the Department of Retirement Systems and the Office of Financial Management may appoint alternates from their respective agencies for membership on the SCPP.

RULE 2. Meetings. The Select Committee on Pension Policy (SCPP) will typically meet once each month during the Legislative Interim. Additional meetings may be called by the Chair of the SCPP or Executive Committee as deemed necessary.

RULE 3. Rules of Order. All meetings of the SCPP, its Executive Committee, or any subcommittee created by the SCPP shall be governed by Reed's Parliamentary Rules, except as specified by applicable law or these Rules of Procedure.

RULE 4. Quorum. A majority of the 20 committee members shall constitute a quorum of the Full Committee (11 members). A majority of the members appointed to a subcommittee shall constitute a quorum of the subcommittee.

RULE 5. Voting. A majority of the 20 committee members must vote in the affirmative for an official action of the SCPP to be valid (11 members), a majority of those committee members present must vote in the affirmative on procedural matters (at least 6 members), unless provided otherwise in statute or these Rules of Procedure. A majority of the members appointed to a subcommittee must vote in the affirmative for an official action of a subcommittee to be valid; a majority of those subcommittee members present must vote in the affirmative on procedural matters, unless provided otherwise in statute or these Rules of Procedure.

RULE 6. Minutes. Minutes summarizing the proceedings of each SCPP meeting and subcommittee shall be kept. These minutes will include member attendance, official actions taken at each meeting, and persons testifying.

RULE 7. SCPP Chair, Vice Chair, Executive Committee and Subcommittees. An Executive Committee shall be established and shall include five members. Reorganization elections shall take place at the first meeting of the year as follows: First the Chair shall be elected and then the Vice Chair shall be elected. The Chair shall be a member of the Senate in even-numbered years and a member of the House of Representatives in odd-numbered years. The Vice Chair shall be a member of the House in even-numbered years and a member of the Senate in odd-numbered years.

Two members of the Executive Committee shall then be elected, one member representing active members and one member representing employers. In addition, the Director of the Department of Retirement Systems and the Director of the Office of Financial Management shall alternate membership on the Executive Committee. The Director of the Department of Retirement Systems will serve on the Executive Committee in odd-numbered years; the Director of the Office of Financial Management in even-numbered years.

Executive Committee members may designate an alternate to attend Executive Committee meetings in the event they cannot attend. Alternates shall be members of the SCPP who represent the same member group as the elected Executive Committee member.

Subcommittees of the SCPP may be formed upon recommendation of the Executive Committee. The creation of the subcommittee and appointment of members shall be voted on by the full SCPP.

RULE 8. <u>Duties of Officers</u>.

A. The Chair shall preside at all meetings of the SCPP and Executive Committee, except that the Vice Chair shall preside when the Chair is not present. In their absence, an Executive Committee member may preside.

B. The State Actuary shall prepare and maintain a record of the proceedings of all meetings of the SCPP Committee, Executive Committee, and SCPP Subcommittees.

C. The Executive Committee shall perform all duties assigned to it by these Rules of Procedure, such other duties delegated to it by the SCPP, and shall set meeting agendas and recommend actions to be taken by the SCPP.

D. A recommendation to refer an issue to the Assistant Attorney General will be approved by the Chair or by a majority vote of the Executive Committee. The Chair or the Committee will consider priorities of the SCPP of all legal issues and budget constraints in making this decision.

Advice from the Attorney General's Office to the Chair or the Committee may be subject to the attorney client privilege. When subject to the privilege, Committee members are advised to maintain the advice as confidential. The privilege may be waived only by vote of the Committee.

E. The State Actuary may refer requests for information or services by Select Committee on Pension Policy members that are directly related to current Committee projects or proposals and/or require a significant use of OSA resources to either the Chair of the SCPP or the Executive Committee. Such requests will be approved by either the Chair or by a majority vote of the Executive Committee prior to initiation and completion by the OSA. The Executive Committee will consider priorities of all current OSA projects and budget constraints in making this decision.

RULE 9. Expenses. Legislators' travel expenses shall be paid by the member's legislative body; state employees' expenses shall be paid by their employing agency; other SCPP members' travel expenses shall be reimbursed by the Office of the State Actuary in accordance with RCW 43.03.050 and 43.03.060.

RULE 10. Staff. The Office of the State Actuary shall provide staff and technical assistance to the Committee.

Adopted September 16, 2003, by the Select Committee on Pension Policy.

Representative Steve Conway, Chair

Senator Shirley Winsley, Vice Chair

CERTIFICATION OF ENROLLMENT

SUBSTITUTE HOUSE BILL 1204

Chapter 295, Laws of 2003

58th Legislature
2003 Regular Session

SELECT COMMITTEE ON PENSION POLICY

EFFECTIVE DATE: 7/27/03

Passed by the House April 26, 2003
Yeas 79 Nays 18

FRANK CHOPP

Speaker of the House of Representatives

Passed by the Senate April 25, 2003
Yeas 48 Nays 0

BRAD OWEN

President of the Senate

Approved May 14, 2003.

GARY LOCKE

Governor of the State of Washington

CERTIFICATE

I, Cynthia Zehnder, Chief Clerk of the House of Representatives of the State of Washington, do hereby certify that the attached is **SUBSTITUTE HOUSE BILL 1204** as passed by the House of Representatives and the Senate on the dates hereon set forth.

CYNTHIA ZEHNDER

Chief Clerk

FILED

May 14, 2003 - 3:25 p.m.

Secretary of State
State of Washington

SUBSTITUTE HOUSE BILL 1204

AS AMENDED BY THE SENATE

Passed Legislature - 2003 Regular Session

State of Washington 58th Legislature 2003 Regular Session

By House Committee on Appropriations (originally sponsored by Representatives Fromhold, Delvin, Conway, Alexander, Pflug, Anderson, Cooper and Chase; by request of Joint Committee on Pension Policy)

READ FIRST TIME 03/04/03.

AN ACT Relating to creating the select committee on pension policy; amending RCW 41.50.110, 44.44.040, 41.40.037, 41.45.020, 41.45.090, 41.45.110, 44.04.260, and 44.44.030; reenacting and amending RCW 41.32.570; adding new sections to chapter 41.04 RCW; creating a new section; decodifying RCW 41.54.061; and repealing RCW 44.44.015, 44.44.050, and 44.44.060.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF WASHINGTON:

NEW SECTION. **Sec. 1.** A new section is added to chapter 41.04 RCW to read as follows:

(1) The select committee on pension policy is created. The select committee consists of:

(a) Four members of the senate appointed by the president of the senate, two of whom are members of the majority party and two of whom are members of the minority party. At least three of the appointees shall be members of the senate ways and means committee;

(b) Four members of the house of representatives appointed by the speaker, two of whom are members of the majority party and two of whom are members of the minority party. At least three of the appointees shall be members of the house of representatives appropriations committee;

(c) Four active members or representatives from organizations of active members of the state retirement systems appointed by the governor for staggered three-year terms, with no more than two appointees representing any one employee retirement system;

(d) Two retired members or representatives of retired members' organizations of the state retirement systems appointed by the governor for staggered three-year terms, with no two members from the same system;

(e) Four employer representatives of members of the state retirement systems appointed by the governor for staggered three-year terms; and

(f) The directors of the department of retirement systems and office of financial management.

(2)(a) The term of office of each member of the house of representatives or senate serving on the committee runs from the close of the session in which he or she is appointed until the close of the next regular session held in an odd-numbered year. If a successor is not appointed during a session, the member's term continues until the member is reappointed or a successor is appointed. The term of office for a committee member who is a member of the house of representatives or the senate who does not continue as a member of the senate or house of representatives ceases upon the convening of the next session of the legislature during the odd-numbered year following the member's appointment, or upon the member's resignation, whichever is earlier. All vacancies of positions held by members of the legislature must be filled from the same political party and from the same house as the member whose seat was vacated.

(b) Following the terms of members and representatives appointed under subsection (1)(d) of this section, the retiree positions shall be rotated to ensure that each system has an opportunity to have a retiree representative on the committee.

(3) The committee shall elect a chairperson and a vice-chairperson. The chairperson shall be a member of the senate in even-numbered years and a member of the house of representatives in odd-numbered years and the vice-chairperson shall be a member of the house of representatives

in even-numbered years and a member of the senate in odd-numbered years.

(4) The committee shall establish an executive committee of five members, including the chairperson, the vice-chairperson, one member from subsection (1)(c) of this section, one member from subsection (1)(e) of this section, and one member from subsection (1)(f) of this section, with the directors of the department of retirement systems and the office of financial management serving in alternate years.

(5) Nonlegislative members of the select committee serve without compensation, but shall be reimbursed for travel expenses under RCW 43.03.050 and 43.03.060.

(6) The office of state actuary under chapter 44.44 RCW shall provide staff and technical support to the committee.

NEW SECTION. **Sec. 2.** A new section is added to chapter 41.04 RCW to read as follows:

(1) The select committee on pension policy may form three function-specific subcommittees, as set forth under subsection (2) of this section, from the members under section 1(1) (a) through (e) of this act, as follows:

(a) A public safety subcommittee with one member from each group under section 1(1) (a) through (e) of this act;

(b) An education subcommittee with one member from each group under section 1(1) (a) through (e) of this act; and

(c) A state and local government subcommittee, with one retiree member under section 1(1)(d) of this act and two members from each group under section 1(1) (a) through (c) and (e) of this act.

The retiree members may serve on more than one subcommittee to ensure representation on each subcommittee.

(2)(a) The public safety subcommittee shall focus on pension issues affecting public safety employees who are members of the law enforcement officers' and fire fighters' and Washington state patrol retirement systems.

(b) The education subcommittee shall focus on pension issues affecting educational employees who are members of the public employees', teachers', and school employees' retirement systems.

(c) The state and local government subcommittee shall focus on pension issues affecting state and local government employees who are members of the public employees' retirement system.

Sec. 3. RCW 41.50.110 and 1998 c 341 s 508 are each amended to read as follows:

(1) Except as provided by RCW 41.50.255 and subsection (6) of this section, all expenses of the administration of the department ((~~and~~))<u>,</u> the expenses of administration of the retirement systems<u>, and the expenses of the administration of the office of the state actuary</u> created in chapters 2.10, 2.12, 41.26, 41.32, 41.40, 41.34, 41.35, ((~~and~~)) 43.43<u>, and 44.44</u> RCW shall be paid from the department of retirement systems expense fund.

(2) In order to reimburse the department of retirement systems expense fund on an equitable basis the department shall ascertain and report to each employer, as defined in RCW 41.26.030, 41.32.010, 41.35.010, or 41.40.010, the sum necessary to defray its proportional share of the entire expense of the administration of the retirement system that the employer participates in during the ensuing biennium or fiscal year whichever may be required. Such sum is to be computed in an amount directly proportional to the estimated entire expense of the administration as the ratio of monthly salaries of the employer's members bears to the total salaries of all members in the entire system. It shall then be the duty of all such employers to include in their budgets or otherwise provide the amounts so required.

(3) The department shall compute and bill each employer, as defined in RCW 41.26.030, 41.32.010, 41.35.010, or 41.40.010, at the end of each month for the amount due for that month to the department of retirement systems expense fund and the same shall be paid as are its other obligations. Such computation as to each employer shall be made on a percentage rate of salary established by the department. However, the department may at its discretion establish a system of billing based upon calendar year quarters in which event the said billing shall be at the end of each such quarter.

(4) The director may adjust the expense fund contribution rate for each system at any time when necessary to reflect unanticipated costs or savings in administering the department.

(5) An employer who fails to submit timely and accurate reports to the department may be assessed an additional fee related to the

increased costs incurred by the department in processing the deficient reports. Fees paid under this subsection shall be deposited in the retirement system expense fund.

(a) Every six months the department shall determine the amount of an employer's fee by reviewing the timeliness and accuracy of the reports submitted by the employer in the preceding six months. If those reports were not both timely and accurate the department may prospectively assess an additional fee under this subsection.

(b) An additional fee assessed by the department under this subsection shall not exceed fifty percent of the standard fee.

(c) The department shall adopt rules implementing this section.

(6) Expenses other than those under RCW 41.34.060((~~(2)~~)) (3) shall be paid pursuant to subsection (1) of this section.

Sec. 4. RCW 44.44.040 and 1987 c 25 s 3 are each amended to read as follows:

The office of the state actuary shall have the following powers and duties:

(1) Perform all actuarial services for the department of retirement systems, including all studies required by law. ((~~Reimbursement for such services shall be made to the state actuary pursuant to the provisions of RCW 39.34.130 as now or hereafter amended.~~))

(2) Advise the legislature and the governor regarding pension benefit provisions, and funding policies and investment policies of the state investment board.

(3) Consult with the legislature and the governor concerning determination of actuarial assumptions used by the department of retirement systems.

(4) Prepare a report, to be known as the actuarial fiscal note, on each pension bill introduced in the legislature which briefly explains the financial impact of the bill. The actuarial fiscal note shall include: (a) The statutorily required contribution for the biennium and the following twenty-five years; (b) the biennial cost of the increased benefits if these exceed the required contribution; and (c) any change in the present value of the unfunded accrued benefits. An actuarial fiscal note shall also be prepared for all amendments which are offered in committee or on the floor of the house of representatives or the senate to any pension bill. However, a majority

of the members present may suspend the requirement for an actuarial fiscal note for amendments offered on the floor of the house of representatives or the senate.

(5) Provide such actuarial services to the legislature as may be requested from time to time.

(6) Provide staff and assistance to the committee established under ((~~RCW 46.44.050~~)) section 1 of this act.

NEW SECTION. **Sec. 5.** A new section is added to chapter 41.04 RCW to read as follows:

The select committee on pension policy has the following powers and duties:

(1) Study pension issues, develop pension policies for public employees in state retirement systems, and make recommendations to the legislature;

(2) Study the financial condition of the state pension systems, develop funding policies, and make recommendations to the legislature;

(3) Consult with the chair and vice-chair on appointing members to the state actuary appointment committee upon the convening of the state actuary appointment committee established under section 13 of this act; and

(4) Receive the results of the actuarial audits of the actuarial valuations and experience studies administered by the pension funding council pursuant to RCW 41.45.110. The select committee on pension policy shall study and make recommendations on changes to assumptions or contribution rates to the pension funding council prior to adoption of changes under RCW 41.45.030, 41.45.035, or 41.45.060.

Sec. 6. RCW 41.32.570 and 2001 2nd sp.s. c 10 s 3 and 2001 c 317 s 1 are each reenacted and amended to read as follows:

(1)(a) If a retiree enters employment with an employer sooner than one calendar month after his or her accrual date, the retiree's monthly retirement allowance will be reduced by five and one-half percent for every seven hours worked during that month. This reduction will be applied each month until the retiree remains absent from employment with an employer for one full calendar month.

(b) The benefit reduction provided in (a) of this subsection will accrue for a maximum of one hundred forty hours per month. Any monthly benefit reduction over one hundred percent will be applied to the benefit the retiree is eligible to receive in subsequent months.

(2) Any retired teacher or retired administrator who enters service in any public educational institution in Washington state and who has satisfied the break in employment requirement of subsection (1) of this section shall cease to receive pension payments while engaged in such service, after the retiree has rendered service for more than one thousand five hundred hours in a school year. When a retired teacher or administrator renders service beyond eight hundred sixty-seven hours, the department shall collect from the employer the applicable employer retirement contributions for the entire duration of the member's employment during that fiscal year.

(3) The department shall collect and provide the state actuary with information relevant to the use of this section for the ((~~joint~~)) select committee on pension policy.

(4) The legislature reserves the right to amend or repeal this section in the future and no member or beneficiary has a contractual right to be employed for more than five hundred twenty-five hours per year without a reduction of his or her pension.

Sec. 7. RCW 41.40.037 and 2001 2nd sp.s. c 10 s 4 are each amended to read as follows:

(1)(a) If a retiree enters employment with an employer sooner than one calendar month after his or her accrual date, the retiree's monthly retirement allowance will be reduced by five and one-half percent for every eight hours worked during that month. This reduction will be applied each month until the retiree remains absent from employment with an employer for one full calendar month.

(b) The benefit reduction provided in (a) of this subsection will accrue for a maximum of one hundred sixty hours per month. Any benefit reduction over one hundred percent will be applied to the benefit the retiree is eligible to receive in subsequent months.

(2)(a) A retiree from plan 1 who has satisfied the break in employment requirement of subsection (1) of this section and who enters employment with an employer may continue to receive pension payments while engaged in such service for up to one thousand five hundred hours of service in a calendar year without a reduction of pension. When a plan 1 member renders service beyond eight hundred sixty-seven hours, the department shall collect from the employer the applicable employer retirement contributions for the entire duration of the member's employment during that calendar year.

(b) A retiree from plan 2 or plan 3 who has satisfied the break in employment requirement of subsection (1) of this section may work up to eight hundred sixty-seven hours in a calendar year in an eligible position, as defined in RCW 41.32.010, 41.35.010, or 41.40.010, or as a fire fighter or law enforcement officer, as defined in RCW 41.26.030, without suspension of his or her benefit.

(3) If the retiree opts to reestablish membership under RCW 41.40.023(12), he or she terminates his or her retirement status and becomes a member. Retirement benefits shall not accrue during the period of membership and the individual shall make contributions and receive membership credit. Such a member shall have the right to again retire if eligible in accordance with RCW 41.40.180. However, if the right to retire is exercised to become effective before the member has rendered two uninterrupted years of service, the retirement formula and survivor options the member had at the time of the member's previous retirement shall be reinstated.

(4) The department shall collect and provide the state actuary with information relevant to the use of this section for the ((~~joint~~)) <u>select</u> committee on pension policy.

(5) The legislature reserves the right to amend or repeal this section in the future and no member or beneficiary has a contractual right to be employed for more than five months in a calendar year without a reduction of his or her pension.

Sec. 8. RCW 41.45.020 and 2002 c 26 s 4 are each amended to read as follows:

As used in this chapter, the following terms have the meanings indicated unless the context clearly requires otherwise.

(1) "Council" means the pension funding council created in RCW 41.45.100.

(2) "Department" means the department of retirement systems.

(3) "Law enforcement officers' and fire fighters' retirement system plan 1" and "law enforcement officers' and fire fighters' retirement

system plan 2" means the benefits and funding provisions under chapter 41.26 RCW.

(4) "Public employees' retirement system plan 1," "public employees' retirement system plan 2," and "public employees' retirement system plan 3" mean the benefits and funding provisions under chapter 41.40 RCW.

(5) "Teachers' retirement system plan 1," "teachers' retirement system plan 2," and "teachers' retirement system plan 3" mean the benefits and funding provisions under chapter 41.32 RCW.

(6) "School employees' retirement system plan 2" and "school employees' retirement system plan 3" mean the benefits and funding provisions under chapter 41.35 RCW.

(7) "Washington state patrol retirement system" means the retirement benefits provided under chapter 43.43 RCW.

(8) "Unfunded liability" means the unfunded actuarial accrued liability of a retirement system.

(9) "Actuary" or "state actuary" means the state actuary employed under chapter 44.44 RCW.

(10) "State retirement systems" means the retirement systems listed in RCW 41.50.030.

(11) "Classified employee" means a member of the Washington school employees' retirement system plan 2 or plan 3 as defined in RCW 41.35.010.

(12) "Teacher" means a member of the teachers' retirement system as defined in RCW 41.32.010(15).

<u>(13) "Select committee" means the select committee on pension policy created in section 1 of this act.</u>

Sec. 9. RCW 41.45.090 and 1998 c 283 s 7 are each amended to read as follows:

The department shall collect and keep in convenient form such data as shall be necessary for an actuarial valuation of the assets and liabilities of the state retirement systems, and for making an actuarial investigation into the mortality, service, compensation, and other experience of the members and beneficiaries of those systems. The department and state actuary shall enter into a memorandum of understanding regarding the specific data the department will collect, when it will be collected, and how it will be maintained. The department shall notify the state actuary of any changes it makes, or intends to make, in the collection and maintenance of such data.

At least once in each six-year period, the state actuary shall conduct an actuarial experience study of the mortality, service, compensation and other experience of the members and beneficiaries of each state retirement system, and into the financial condition of each system. The results of each investigation shall be filed with the department, the office of financial management, the budget writing committees of the Washington house of representatives and senate, the select committee on pension policy, and the pension funding council. Upon the basis of such actuarial investigation the department shall adopt such tables, schedules, factors, and regulations as are deemed necessary in the light of the findings of the actuary for the proper operation of the state retirement systems.

Sec. 10. RCW 41.45.110 and 1998 c 283 s 3 are each amended to read as follows:

The pension funding council shall solicit and administer a biennial actuarial audit of the actuarial valuations used for rate-setting purposes. This audit will be conducted concurrent with the actuarial valuation performed by the state actuary. At least once in each six-year period, the pension funding council shall solicit and administer an actuarial audit of the results of the experience study required in RCW 41.45.090. Upon receipt of the results of the actuarial audits required by this section, the pension funding council shall submit the results to the select committee on pension policy.

NEW SECTION. **Sec. 11.** RCW 41.54.061 is decodified.

Sec. 12. RCW 44.04.260 and 2001 c 259 s 1 are each amended to read as follows:

The joint legislative audit and review committee, the legislative transportation committee, the ((~~joint~~)) select committee on pension policy, the legislative evaluation and accountability program committee, and the joint legislative systems committee are subject to such operational policies, procedures, and oversight as are deemed necessary by the facilities and operations committee of the senate and the executive rules committee of the house of representatives to ensure operational adequacy of the agencies of the legislative branch. As used in this section, "operational policies, procedures, and oversight" includes the development process of biennial budgets, contracting procedures, personnel policies, and compensation plans, selection of a chief administrator, facilities, and expenditures. This section does not grant oversight authority to the facilities and operations committee of the senate over any standing committee of the house of representatives or oversight authority to the executive rules committee of the house of representatives over any standing committee of the senate.

NEW SECTION. **Sec. 13.** (1) The state actuary appointment committee is created. The committee shall consist of: (a) The chair and ranking minority member of the house of representatives appropriations committee and the chair and ranking minority member of the senate ways and means committee; and (b) four members of the select committee on pension policy appointed jointly by the chair and vice-chair of the select committee, at least one member representing state retirement systems active or retired members, and one member representing state retirement system employers.

(2) The state actuary appointment committee shall be jointly chaired by the chair of the house of representatives appropriations committee and the chair of the senate ways and means committee.

(3) The state actuary appointment committee shall appoint or remove the state actuary by a two-thirds vote of the committee. When considering the appointment or removal of the state actuary, the appointment committee shall consult with the director of the department of retirement systems, the director of the office of financial management, and other interested parties.

(4) The state actuary appointment committee shall be convened by the chairs of the house of representatives appropriations committee and the senate ways and means committee (a) whenever the position of state actuary becomes vacant, or (b) upon the written request of any four members of the appointment committee.

Sec. 14. RCW 44.44.030 and 2001 c 259 s 11 are each amended to read as follows:

(1) Subject to RCW 44.04.260, the state actuary shall have the authority to select and employ such research, technical, clerical personnel, and consultants as the actuary deems necessary, whose salaries shall be fixed by the actuary and approved by the ((~~joint committee on pension policy~~)) <u>the state actuary appointment committee</u>, and who shall be exempt from the provisions of the state civil service law, chapter 41.06 RCW.

(2) All actuarial valuations and experience studies performed by the office of the state actuary shall be signed by a member of the American academy of actuaries. If the state actuary is not such a member, the state actuary, after approval by the <u>select</u> committee, shall contract for a period not to exceed two years with a member of the American academy of actuaries to assist in developing actuarial valuations and experience studies.

<u>NEW SECTION.</u> **Sec. 15.** The following acts or parts of acts are each repealed:

(1) RCW 44.44.015 (Administration) and 2001 c 259 s 10;

(2) RCW 44.44.050 (Joint committee on pension policy--Membership, terms, leadership) and 1987 c 25 s 4; and

(3) RCW 44.44.060 (Joint committee on pension policy--Powers and duties) and 1987 c 25 s 5.

Passed by the House April 26, 2003.
Passed by the Senate April 25, 2003.
Approved by the Governor May 14, 2003.
Filed in Office of Secretary of State May 14, 2003.

Joint Committee on Pension Policy

Rules of Procedure

Revised December 13, 2000

RULE 1. Membership. The committee shall be composed of 16 members, 4 from each major caucus of the legislature. Appointments are for a biennium beginning at the close of the session in which the member is appointed and ending at the close of the next regular session held in an odd-numbered year or until a successor is appointed.

RULE 2. Meetings. The Joint Committee on Pension Policy (JCPP) may meet once each month during the Legislative Interim, or at such other times when called by the chair or by the executive committee. The date, time, and place shall be set by the chair or executive committee. A good faith effort will be made to put notices of meetings in the printed monthly legislative meeting schedule and in the schedule available on the internet during the interim. A minimum of seven days' notice of any meeting shall be given.

RULE 3. Rules of Order. All meetings of the JCPP, its executive committee, or any subcommittee created by the JCPP, shall be governed by Reed's Parliamentary Rules, except as specified by applicable law or these Rules of Procedure.

RULE 4. Quorum. A majority of the members shall constitute a quorum.

RULE 5. Voting. A majority of committee members must vote in the affirmative for an action of the committee to be valid, unless provided otherwise in statute or these Rules of Procedure.

RULE 6. Minutes. Minutes summarizing the proceedings of each JCPP meeting shall be kept. These minutes will include member attendance, any official actions taken at each meeting, and persons testifying.

RULE 7. JCPP Executive Committee. The JCPP shall reorganize promptly after the biennial appointment of members under Chapter 44.44 RCW.

An executive committee shall be established and shall include the immediate previous chair or co-chairs and four members elected by the JCPP, representing the four major caucuses. Reorganization elections shall take place as follows: First, a chair shall be elected and then a vice-chair shall be elected. The chair shall be a member of the Senate in even-numbered years and a member of the House of Representatives in odd-numbered years. The chair and vice-chair shall be from opposite chambers.

In the event that membership in the House of Representatives is evenly split between caucuses in an odd-numbered year, the Committee shall elect a co-chair from each of the two major caucuses of the House. In the event that membership in the House of Representatives is evenly split between caucuses in an even-numbered year, the Committee shall elect co-vice-chairs from each of the two major caucuses in the House."

RULE 8. Duties of Officers.

A. The chair shall preside at all meetings of the JCPP and executive committee, except that the vice chair shall preside when the chair is not present. In their absence, an executive committee member may preside.

B. The State Actuary shall prepare and maintain a record of the proceedings of all meetings of the JCPP and executive committee.

C. The executive committee shall perform all duties assigned to it by these Rules of Procedure, and such other duties delegated to it by the JCPP, and shall set meeting agendas and recommend actions to be taken by the JCPP.

RULE 9. Resolutions and Proposals. Proposals for JCPP consideration or action on any subject within the scope of JCPP's authority may be presented orally or in writing by any member of the JCPP. Resolutions addressed to the JCPP by the Washington State Legislature or either chamber thereof shall be deemed to have been presented to the JCPP without further action by any member. Proposals for JCPP consideration or action on any subject within the scope of JCPP's authority may be presented in writing to JCPP by any member of the legislature.

RULE 10. Expenses. The biennial budget submission for the office of the state actuary shall be approved by the executive committee. JCPP members' travel expenses shall be paid by the member's legislative body.

RULE 11. State Actuary. If a vacancy occurs, the JCPP shall appoint a state actuary by a two-thirds majority from a list of applicants recommended by the executive committee. The state actuary shall serve as the chief of staff for the JCPP and shall perform such duties as the JCPP or its executive committee may require.

The compensation of the state actuary shall be determined by the executive committee and the executive committee shall provide for a regular performance evaluation of the state actuary.

The state actuary may be terminated based on the recommendation of the executive

The state actuary may be terminated based on the recommendation of the executive committee subject to the approval of two-thirds of the membership of the JCPP.

RULE 12. Other Staff.

A. The state actuary shall have the authority to select and employ such research, technical, clerical personnel, and consultants as the state actuary deems necessary.

B. The number of permanent employees and the salary ranges for their positions shall be approved by the executive committee.

C. The executive committee shall approve all personal service contracts in excess of $5,000.00.

D. All staff members shall report to and be subject to the direction of the state actuary, and be exempt from the provisions of the state civil service law, chapter 41.06 RCW. The state actuary shall advise the executive committee on personnel actions. Anyone terminated by the state actuary shall have the right of appeal to the executive committee.

E. Grievance Procedure. An employee who is dissatisfied with a personnel action or employment conditions shall bring the matter to their supervisor. If they continue to be dissatisfied, the employee may appeal to the State Actuary. If the employee disagrees with the decision or action of the State Actuary, the employee may appeal to the chair or vice chair for action by the executive committee.

Adopted December 13, 2000, by the Joint Committee on Pension Policy:

Karen Fraser

Senator Karen Fraser, Chair

Mark L. Doumit

Representative Mark Doumit, Co-Vice-Chair

Kathy Lambert

Representative Kathy Lambert, Co-Vice-Chair

Gain-Sharing

(August 10, 2004)

Issue

Gain-sharing was first implemented in 1998, based on certain assumptions, goals, and policies. This issue paper examines those assumptions, goals and policies in light of the impacts and experience of gain-sharing over the last five years. This report also explores some of the legal, technical and actuarial issues associated with gain-sharing. The report is intended as an overview as well as a tool for evaluating the gain-sharing provisions in current law.

Staff

Laura C. Harper, Sr. Research Analyst/Legal
360-586-7616

Members Impacted

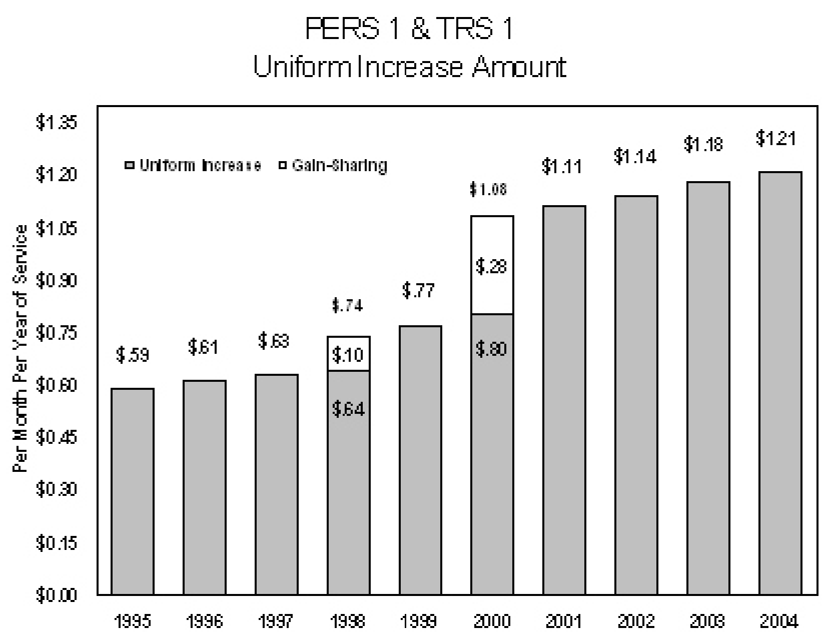
Gain-sharing directly affects retired members of TRS and PERS Plans 1. As of the most recent actuarial valuation (2002), there were 33,148 retirees in TRS 1 and 54,006 retirees in PERS 1. Gain-sharing also affects term-vested, active and retired members of the TRS, SERS and PERS Plans 3. "Term-vested" members are those who left employment, were vested, and who did not withdraw their contributions. As of the most recent actuarial valuation, TRS 3 had 2,151 term-vested members, 45,798 active members and 283 retirees; SERS 3 had 1,148 term-vested members, 26,921 active members, and 185 retirees; and PERS 3 had 198 term-vested members, 15,509 active members and 9 retirees. Plan 2 members do not participate in gain-sharing.

Current Situation

Gain-sharing is a mechanism that increases benefits in PERS 1, TRS 1 and all the Plans 3 (TRS 3, SERS 3 and PERS 3). These increases are not automatic, but are contingent on the occurrence of "extraordinary investment gains." Extraordinary investment gains occur when the compound average of investment returns on pension fund assets exceeds 10% for the previous four state fiscal years. The "compound average" recognizes the affect of compound interest. (Compound interest is interest paid on previously earned interest as well as on the principal.)

When the previous four-year compound average investment return exceeds 10%, a calculation is performed to determine a dollar amount that will be distributed to eligible members. Gain-sharing calculations are currently made once each biennium with potential distributions occurring in January of even-numbered years.

Plan 1 gain-sharing is governed by Chapter 41.31 RCW. As implemented for PERS/TRS 1, an amount equal to one-half of the extraordinary investment returns is used to permanently boost the Annual Increase Amount used in calculating the Uniform Cost of Living Adjustment (COLA). The following graph illustrates how gain-sharing distributions have impacted the uniform increase amount.



Plan 3 gain-sharing is governed by Chapter 41.31A RCW. In the Plans 3, active, retired and term-vested members are eligible for gain-sharing distributions. Distributions are made as a lump sum dollar amount that is deposited directly into member's defined contribution account based on years of service credit. The same 10% rate of return in used to determine when extraordinary gains have occurred. A second calculation is then made to determine the dollar amount to be distributed to eligible members. Eligible Plan 3 members' service is divided by all system members' service. This produces the percentage of Plan 2/3 retirement funds which can be attributed to Plan 3 members' service. The Plan 3 percentage is then multiplied by one-half of the dollar amount of extraordinary gains. The Department of Retirement Systems then deposits a fixed dollar amount per year of service to each eligible member.

Example: Plan 3 Gain-sharing Calculation for Year 2000

Gain Sharing Rate	
1995-1996	17.40%
1996-1997	20.50%
1997-1998	16.60%
1998-1999	11.90%
4 Year Average	16.56%
Gain-sharing %	6.56%
Years of Service (YOS) for Eligible Plan 3 Members	286,702.27
Years of Service for Other Members	1,518,868.57
Total YOS	1,805, 570.84
Ratio of Plan 3 to Total (rounded)	15.88%
Total Gain-Sharing Potential	$458,990,372
Gain-sharing Plan 3	$72,887,671
Gain-sharing per Plan 3 YOS	$254.23

History

Legislation

Gain-sharing legislation was first passed in **1998**. At that time, the Washington State Retirement Systems had been experiencing high rates of returns on plan assets. ESHB 2491 (Chapter 340, Laws of 1998) became effective immediately and established gain-sharing for the PERS and TRS Plans 1. The first gain-sharing distribution was scheduled for July 1, 1998.

SSB 6306 (Chapter 341, Laws of 1998) established gain-sharing for the TRS and SERS Plans 3. The TRS 3 provisions took effect immediately and the SERS provisions were to become effective on September 1, 2000 with the creation of SERS. SERS members would receive retroactive gain-sharing on March 1, 2001, based upon service credit accumulated as of August 1997. A second gain-sharing calculation for SERS 3 members was scheduled for March 2001, based upon service credit accumulated as of August 1999.

HB 1023 (Chapter 223, Laws of **1999**) addressed a technical correction to TRS 3 gain-sharing provisions that had passed in the previous legislative session. The 1999 law was designed to allow most TRS 3 members who had transferred from TRS 2 to TRS 3 to receive gain-sharing distributions as intended by the legislature in 1998.

In the year **2000**, ESSB 6530 (Chapter 247, Laws of 2000) created the PERS 3 gain-sharing provisions, which were the same as had been previously provided to TRS 3 and SERS 3. PERS Plan 3 was to become effective on March 1, 2002. The first gain-sharing payment was to be made March 1, 2003, and would be equal to the gain-sharing payments made to TRS Plan 3 members in January 2000.

2003 legislation affecting gain-sharing provisions involved only certain technical corrections involving statutory cross-references. Other non-SCPP bills have been introduced to: increase the frequency of gain-sharing distributions; change the definition of “extraordinary gains” by lowering the interest rate threshold from 10% to 8%; provide for lump sum payments in lieu of Plan 1 COLA increases; distribute gain-sharing to retirees based upon a point system (1 point for each year of service credit and 2 points for each year of retirement); and apply gain-sharing to members of LEOFF Plan 2. None of the non-SCPP bills concerning gain-sharing have passed.

Historical gain-sharing

The following table summarizes past gain-sharing distributions to members of the Plans 1 and 3:

Historical Gain-sharing (Dollars in Millions)

Distribution Date	PERS1/TRS 1	TRS 3*	SERS 3**	PERS 3***
7/1/1998	$290	$28		
1/1/2000	$634	$73	$50	$26

* TRS 3 members received both 1998 and 2000 gain-sharing distributions. Payments were not retroactive.
**SERS 3 members received both 1998 and 2000 gain-sharing distributions. Payments were retroactive. The total for both distributions is reflected in the 1/1/2000 row.
***PERS 3 members received gain-sharing for 2000 only. Payments were retroactive.

The total dollars spent for benefit improvements in the past two gain-sharing distributions was roughly $1.1 billion. These distributions do not include dollars allocated to shorten the amortization period for the Plans 1. Those dollars amounted to another $290 million in 1998 and $634 million in 2000 for a grand total of roughly $2 billion. In 2001, however, the Plan 1 payoff date was extended back out to 2024, the same as it was prior to gain-sharing. The benefit enhancements and the adjustments to the Plan 1 amortization period are described in more detail below.

Policy Analysis

The original gain-sharing mechanism was developed within a framework of Joint Committee on Pension Policy goals. The goals for gain-sharing included:

1. An on-going process that is understandable, stable, and would take place with meaningful frequency.
2. No additional unfunded long-term liabilities.
3. Immediate benefit improvements funded by recent investment gains.
4. Future benefit improvements whenever the assets invested in the retirement trust accounts experience extraordinary gains.
5. An acceleration of the date for paying off the unfunded actuarial liability of PERS 1 and TRS 1.

It was also expected that funding benefit improvements when there are extraordinary investment returns gains would decrease the effect of those returns on employer contribution rates. In other words, it was expected that employer contribution rates would not flatten or be driven downward if the gains triggered benefit improvements and reductions of the Plan 1 unfunded liabilities. See Gain Sharing, Report to the Joint Committee on Pension Policy, January 13, 1998. This approach seemed to assume that future employer rates would be set in response to market forces. They would go down when markets are good, and back up when markets are bad. While legislatures may choose to set contribution rates on an ad hoc basis, there are other ways to address contribution rate-setting. See Contribution Rate Setting, July 2, 2004 Report to the SCPP by the State Actuary.

This policy analysis will compare these goals to the experience of the last five years. This section of the report will also explore some of the technical/legal and actuarial constraints that affect gain-sharing.

Goal 1: An ongoing process that is understandable, stable, and would take place with meaningful frequency.

Gain-sharing is ongoing in the sense that it is a benefit enhancement that has been built into the affected plans through the mechanism of pension plan amendments. These plan amendments require that gain-sharing distributions be made in the future whenever certain specified conditions are met. The gain-sharing provisions are, however, subject to a "no contractual right" clause. This clause states that "no member or beneficiary has a contractual right to receive this distribution not granted prior to that time." These kinds of clauses have not been tested in the Washington courts. This legal uncertainty lends an aspect of unpredictability to the gain-sharing benefit.

Gain-sharing distributions have been triggered in two instances in the last five years. The first distribution occurred on July 1, 1998. Thereafter, gain-sharing distributions were to occur on January 1st of even-numbered years, assuming that the affected plans experienced extraordinary investment returns. The second distribution was triggered for January 1, 2000. On January 1 of 2002 and 2004, there were no extraordinary investment returns available to trigger a gain-sharing distribution.

The frequency of gain-sharing in the future is tied to annual investment returns, which are unpredictable. When gain-sharing legislation was passed in 1998, it was estimated that the 10% threshold for distribution of extraordinary gains would have been exceeded in 21 of the past 34 biennia. However, the past is not necessarily a predictor of the future. While the trigger mechanism for gain-sharing is fixed, the incidence of future gain-sharing is unknown.

In summary, the frequency of future gain-sharing is:

– subject to legal uncertainty;
– unpredictable due to market fluctuations.

Goal 2: No additional unfunded long-term liabilities.

At its inception, gain-sharing was almost viewed as a "no cost" item, i.e. it would only occur when times were good, and it would simply keep employer contribution rates from going down during those good times. In addition, the law has not allowed for any adjustment to the **supplemental** contribution rate for gain-sharing. See RCW 41.45.070(7). The supplemental rate is a temporary contribution rate increase that is made to reflect the cost of benefit changes until those changes can be included in the next actuarial valuation.

The future cost of the gain-sharing benefit provisions of PERS and TRS Plans 1, and PERS, TRS and SERS Plans 3 was not reflected in the 2002 actuarial valuation. However, the actuarial certification in the 2002 Actuarial Valuation Report noted that the funding methodology and materiality of the gain-sharing provisions were under review. Such review is required by the Actuarial Standards of Practice promulgated by the American Academy of Actuaries. (See Standards 4 and 27.) These standards require that material liabilities of the plan be identified so they can be "pre-funded." The State Actuary is now identifying gain-sharing as a material liability due to the future cost associated with this benefit, and this liability will be reflected in the 2003 Actuarial Valuation.

Estimated Fiscal Impact of Future Gain-Sharing

Future gain-sharing will impact the actuarial funding of the systems by increasing the present value of benefits payable under the systems and the required actuarial contribution rates as shown below:

(Dollars in Millions)		Current	Increase	Total
Actuarial Present Value of Projected Benefits (The Value of the Total Commitment to all Current Members)	PERS 1	$12,722	$504	$13,226
	PERS 2/3	14,159	119	14,278
	TRS 1	10,341	426	10,767
	TRS 2/3	4,876	344	5,220
	SERS 2/3	1,979	159	2,138
Unfunded Actuarial Accrued Liability (The Portion of the Plan 1 Liability that is Amortized at 2024)	PERS 1	$2,134	$492	$2,626
	TRS 1	1,012	403	1,415

Increase in Contribution Rates: (Effective 2005)	PERS	SERS	TRS
Employee	0.00%	0.00%	0.00%
Employer State	0.53%	2.05%	1.79%

Fiscal Budget Determinations

As a result of the higher required contribution rates, the increase in funding expenditures is projected to be:

(Dollars in Millions)	PERS	SERS	TRS	Total
2005-2007				
State:				
General Fund	$16.1	$27.6	$109.1	$152.8
Non-General Fund	26.7	0.0	0.0	26.7
Total State	**$42.8**	**$27.6**	**$109.1**	**$179.5**
Local Government	37.9	24.4	22.4	84.7
Total Employer	80.7	52.0	131.5	264.2
Total Employee	$0.0	$0.0	$0.0	$0.0
2007-2009				
State:				
General Fund	$19.6	$35.7	$134.4	$189.7
Non-General Fund	32.4	0.0	0.0	32.4
Total State	**$52.0**	**$35.7**	**$134.4**	**$222.1**
Local Government	46.1	31.8	27.6	105.5
Total Employer	98.1	67.5	162.0	327.6
Total Employee	$0.0	$0.0	$0.0	$0.0

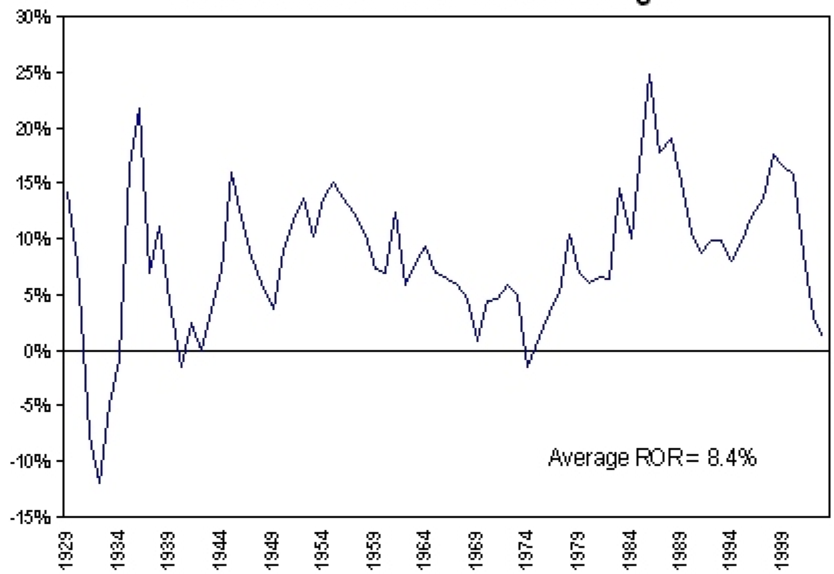
(Dollars in Millions)	PERS	SERS	TRS	Total
2005-2030				
State:				
General Fund	$352.9	$801.7	$2,558.1	$3,712.7
Non-General Fund	582.4	0.0	0.0	582.4
Total State	**$935.3**	**$801.7**	**$2,558.1**	**$4,295.1**
Local Government	829.4	710.9	524.0	2,064.3
Total Employer	1,764.7	1,512.6	3,082.1	6,359.4
Total Employee	$0.0	$0.0	$0.0	$0.0

The costs presented in this estimate are based on our understanding of existing gain-sharing provisions as well as generally accepted actuarial standards of practice including the following:

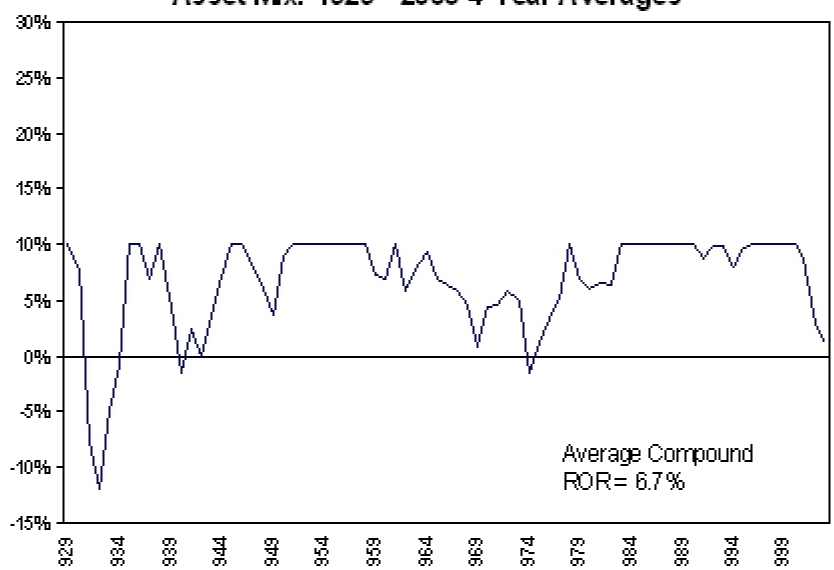
1. *Costs were developed using the same membership data, methods, assets and assumptions as those used in preparing the September 30, 2003 draft actuarial valuation report of the Retirement Systems.*
2. *As with the costs developed in the actuarial valuation, the emerging costs of the systems will vary from those presented in the valuation report or any fiscal note to the extent that actual experience differs from that projected by the actuarial assumptions.*
3. *The funding method used for Plan 1 utilizes the Plan 2/3 employer/state rate as the Normal Cost and amortizes the remaining liability (UAAL) by the year 2024. Benefit increases to Plan 2/3 will change the UAAL in Plan 1. The cost of benefit increases to Plan 1 increases the UAAL.*
4. *Plan 2/3 utilizes the Aggregate Funding Method. The cost of Plan 2/3 is spread over the average working lifetime of the current active Plan 2/3 members.*
5. *The employee/employer level of cost-sharing as defined in the actuarial funding chapter - Chapter 41.45 RCW - provides that the cost of Plan 3 benefit enhancements is shared equally among Plan 2/3 employers and Plan 2 employees.*

Alternatively, the cost of gain-sharing can be illustrated by the following charts, which show the effects of gain-sharing on investment returns. The first chart shows the average compound rate of return (ROR) using today's retirement plan asset mix as spread over the 1929 to 2003 period, which yields an 8.4% rate of return. (Currently, the assumed actuarial rate of return is 8%.) The second chart shows the average compound rate of return using the same asset mix over the same period with the addition of gain-sharing. The gain-sharing provisions lower the rate of return from 8.4% to 6.7%.

Investment Rate of Return by Current Asset Mix: 1929 - 2003 4-Year Averages



Investment Rate of Return by Current Asset Mix: 1929 - 2003 4-Year Averages



The second chart illustrates that the "peaks" of investment returns have been "skimmed" for gain-sharing distributions to accommodate the statutory formula that has been implemented since 1998. Applying the gain-sharing formula on a "look back" at the 1929-2003 period, we see a significantly lower average compound rate of return. The rate of return is lowered because the peaks are no longer available to offset the "valleys" or low periods of investment returns. The valleys remain the same, while the peaks are "lopped off." This pattern could change depending on the asset allocation policy of the State Investment Board. For example, if certain high-risk/high-return asset classes such as real estate or private equity were dropped from the portfolio, there could be fewer instances of "extraordinary gains."

An original goal of gain-sharing was "no additional unfunded liabilities." However due to the fact that future gain-sharing distributions have not been pre-funded, gain-sharing has significantly increased the unfunded long-term liabilities of the affected plans.

Goal 3: Immediate benefit improvements funded by recent investment gains.

The gain-sharing legislation for the Plans 1 became effective immediately and thus resulted in immediate benefit improvements. The first gain-sharing distribution in 1998 provided a $.10 increase in the Annual Increase Amount used to calculate the Uniform COLA. The Uniform COLA provides a cost-of-living adjustment to Plan 1 retirees beginning at age 66 based on the retiree's service credit. The Uniform COLA began in 1995 at $.59 per month per year of service credit and increases 3% annually. When gain-sharing was passed in 1998, the Uniform COLA was at $.63 per month per year of service. The $.10 increase was permanent and is part of the base for determining the regular annual increases.

The 1998 gain-sharing distribution also paid the actuarial present value (using a one-time payment) of a retroactive "pop-up" benefit for retirees who retired prior to 1996 and elected a survivor benefit. The "pop-up" provided that if the retiree is predeceased by the beneficiary, the retiree's benefit is restored to its unreduced level at the beginning of the month following the death of the beneficiary. Those retirees who had already been predeceased by their beneficiaries had their benefits restored on the effective date of the act (July 1, 1998). The one-time cost of providing this benefit was $52 million.

The 1998 gain-sharing distribution to Plan 3 members was $134.43 per year of service credit. The gain-sharing amounts were distributed as lump sums deposited into Plan 3 members' defined contribution accounts.

Were these benefit improvements "funded by" recent investment gains? As explained when gain-sharing was first proposed, there are two primary methods for funding benefit improvements: a contribution rate increase, or a present-value payment. A contribution rate increase pays off the cost of the new benefit over time. A present-value payment is a one-time payment **into** the retirement system to cover all the estimated future costs of the benefit.

Past gain-sharing distributions resulted in transfers from the retirement trust accounts to individual members. Significant dollars were paid out of the retirement system. Past gain-sharing benefits were paid for in the sense that employer contribution rates stayed at a higher level than they would have absent gain-sharing. However no mechanism was established to pay for future gain-sharing. Many have assumed that the "extraordinary gains" somehow pay for the benefits. However "extraordinary gains" are simply the market events that triggered the timing of benefit improvements. Their long-term cost must be funded by either higher contribution rates or appropriations of new money into the retirement system.

In thinking about the fact that gain-sharing itself is not a funding mechanism for future benefit improvements, it may be useful to compare extraordinary investment gains with actuarial gains. Actuarial gains are generated by favorable plan experience. In other words, when a retirement plan is funded based on certain assumptions (including the assumed rate of investment return and various demographic assumptions) that are too conservative, it is more likely that the long-term plan experience will be more favorable than the assumptions. Favorable plan experience generates actuarial gains.

When assumptions are not conservative enough, there is less opportunity for favorable plan experience. Without favorable plan experience, there are no gains and there may even be increases in liability. Generally, actuarial assumptions are periodically adjusted to be as consistent as possible with plan experience. Thus, overall, actuarial gains are used to offset actuarial losses, just as investment gains offset investment losses.

When benefit enhancements are funded indirectly though temporary gains and not directly through increased contribution rates or one-time pay-outs, then those gains are no longer available in the future to offset losses. In effect, it is as if the gains have been capped. The approach leads to increased future liabilities. This is not to say that retirement plans never have surpluses which can be used for reasonable benefits enhancements. However, an asset surplus is not the same as a prolonged stock market surge. An asset surplus occurs when all liabilities have been satisfied and there is still money left over. This is not the case in the Plans 1 or the Plans 3; thus benefit improvements still require a funding mechanism that is related to their cost.

In summary, in accordance with its original goals, gain-sharing generated significant immediate benefit improvements upon passage of the initial legislation. Those enhancements, however, were not funded by recent investment gains; rather, the benefit improvements were funded by employer contributions. Similarly, future benefit enhancements that are triggered by gain-sharing events will require additional funding in order to avoid future increases in plan liabilities.

Goal 4: Future benefit improvements whenever the assets invested in the retirement trust accounts experience extraordinary gains.

Looking at the future from the perspective of the Joint Committee on Pension Policy in 1998, we see that the 2000 gain-sharing distribution was much larger than the 1998 distribution. It provided a second permanent increase in the Uniform COLA amount for TRS 1 and PERS 1 of $.28 as of January 1, 2000. Eligible members of the Plans 3 received $254.23 per year of service credit as lump sums deposited into their defined contribution. There were no gain-sharing distributions in 2002 or 2004.

As mentioned before, while the trigger mechanism for gain-sharing is fixed, the incidence of future gain-sharing is unknown. Also, as explained earlier, while gain-sharing provisions trigger certain future benefit payments according to a pre-determined formula that varies with the size of the investment gains, there is no official funding mechanism provided to pay for the resulting benefit improvements that will occur. It is simply assumed that a) gain-sharing will only occur when contribution rates are otherwise decreasing, and b) the distributions will result in employer contribution rates remaining at a higher level than they would have been absent gain-sharing.

Goal 5: An acceleration of the date for paying off the unfunded actuarial liability of PERS Plan 1 and TRS Plan 1.

Accelerating the date for paying off the unfunded actuarial accrued liability (UAAL) has an effect on contribution rates. When the amortization period for plan liabilities is shortened, contribution rates must be higher. When the amortization period is lengthened, contribution rates can be lower. This is similar to a mortgage payment, in that a shorter mortgage period means a higher monthly payment and a longer mortgage period means a lower monthly payment. In PERS 1 and TRS 1, member contribution rates are fixed by statute at 6% of pay. Thus, when contribution rates fluctuate due to a change in the amortization period, it is the employer contribution rate that is adjusted.

The original gain-sharing legislation provided that an amount equal to one-half of the extraordinary investment gains would be used to shorten the amortization period for unfunded liabilities in PERS 1 and TRS 1. This provision of the original gain-sharing legislation was codified in RCW 41.45.060(5). In 1998, the unfunded liability amortization period was rolled back from 2024 to 2022. In 2000, the amortization period was rolled back from 2022 to December 31, 2016. Then in 2001, the provision requiring that gain-sharing distributions be used to pay off the unfunded liability of the Plans 1 dropped out of the law. The amortization period for PERS and TRS Plan 1 unfunded liability was extended back out to 2024.

Currently there is no legal requirement that gain-sharing distributions be used to reduce the unfunded liability of PERS 1 or TRS 1. Furthermore, the scheduled payoff date of June 30, 2024 for Plan 1 liabilities is now the same as it was before gain-sharing.

Policy Constraints

Funding policies in the Actuarial Funding Chapter

The following general funding policies have been adopted for the Washington State Retirement Systems, and are codified in RCW 41.45.010:

1. to continue to fully fund the Plans 2 and 3;
2. to fully amortize the total costs of the Plans 1 by 2024;

3. to establish predictable long-term employer contribution rates which will remain a relatively constant proportion of future state budgets; and
4. to fund benefit increases over the working lives of members so the cost of those benefits are paid by the taxpayers who receive the benefit of those members' service.

Gain-sharing was originally passed to be funded on a pay-as-you-go basis. It was expected that employer contribution rates would simply be kept higher during those times when they would otherwise be going down in response to favorable market returns. Also, the pay-as-you go approach was favored because of difficulties in projecting future gain-sharing events and their attendant liabilities.

Because future gain-sharing benefits have not been pre-funded, gain-sharing may be viewed as inconsistent with the above funding policies. With respect to policy #1, gain-sharing has a significant cost that is not reflected in current employer contribution rates. To that extent it may be said that the Plans 3 are not fully funded. Policy #2 calls for the unfunded liabilities of the Plans 1 to be paid off by 2024. To the extend that gain-sharing provides for permanent future benefit increases that have not been pre-funded, there is the possibility that future gain-sharing would create additional unfunded liability, thereby extending the pay-off date. With respect to policy #3, we know that future gain-sharing events will occur irregularly during the future due to market volatility. If gain-sharing benefits are not pre-funded, then employer contribution rates will be adjusted to accommodate gain-sharing benefits only in response to market fluctuations. It may be said that this type of funding is not predictable or systematic. Finally, due to the unpredictability of gain-sharing events, some generations of taxpayers may be benefitted by gain-sharing distributions more than others, while some may be burdened more than others. If so, the gain-sharing program would be inconsistent with policy #4.

Parity among plans

RCW 41.50.005(1) sets forth as retirement policy that the retirement systems of the state shall provide similar benefits whenever possible. The application of gain-sharing to members is currently very different for the Plans 1, the Plans 2 and the Plans 3 of the Washington State Retirement systems. When gain-sharing distributions are triggered, members of PERS 1 and TRS 1 receive permanent increases through the Uniform COLA, while Plan 3 members receive lump sum distributions into their defined contribution accounts. Plan 2 members to not participate directly in gain-sharing. Theoretically, they participate indirectly by having their contribution rates adjusted (along with that of their employers).

In the Plans 1, members have no control over their contribution rate, which is statutorily set at 6%. In the Plans 3, which are hybrid plans, members decide (from six options) how much they will contribute to the defined contribution portion of their plan. (The Plan 3 defined benefit is employer-provided.) In the Plans 2, member contribution rates change to reflect the cost of the plan.

Theoretically Plan 2 members, like employers, can enjoy lower contribution rates when economic times are good. However, since Plan 2 member contribution rates change to reflect the cost of the plan, their contribution rates are also subject to increase when economic times are bad. In other words, Plan 2 members are sharing in both gains and losses, which offset each other over time under a reasonable set of actuarial assumptions. This is in direct contrast to gain-sharing for members of the Plans 1 and 3, who receive permanent benefit improvements without participating in the offsetting losses.

Federal Law Constraints

Final regulations were effective June 15, 2004 concerning required minimum distributions under Internal Revenue Code Section 401(a)(9). Under these rules, tax benefits that were given during a participant's working years are recaptured from pay-outs during the retirement years. Generally, the rules limit the ability to avoid taxes by "back loading" annuities to pay less in the early years of retirement. In particular, the regulations permit increases in payments solely to reflect better-than-assumed investment performance, e.g. gain-sharing. However, there are specific requirements related to the measurement of actuarial gains from investment experience. These requirements should be reviewed with tax counsel to assure on-going compliance with Section 401(a)(9).

Private Sector Models

In the private sector, many companies provide what is known as "profit sharing." With profit sharing, a company establishes a target profit level. If actual profits exceed the target, then a percentage of the excess is divided among employees. There are several types of profit sharing plans: current distribution (cash) plans, deferred payout plans and combination plans. Under current distribution plans, a profit sharing bonus is paid in cash or in shares. Under deferred payout plans, the profit sharing amount is placed in trust for later payment at termination or retirement. There are also combination or hybrid profit sharing plans that use elements of both current distribution elements and deferred payout elements.

Another form of profit- or gain-sharing is to grant bonuses to employees who generate ideas or take actions that result in cost-savings for their employer. These programs have been used more in the private sector, but have also been used in the public sector to promote government efficiency, for example in Baltimore County, North Carolina and Washington.

Gain-sharing is relatively new in the public sector. According to a nationwide survey by Fox, Lawson & Associates, fewer than 6% of public sector organizations in the United States, from school districts up through state-level organizations, had implemented a gain-sharing program in 1997. This may be explained, in part, by the fact that governmental retirement systems are not funded to generate profits. Public retirement systems are typically funded so that the liabilities of member benefits are completely funded over the working lifetime of the members. If there is a surplus then taxpayers and members have paid too much. If there is unfunded liability that is too large to be amortized over the working lifetime of the members, then taxpayers and members have paid too little. Actuaries assist employers in setting contribution rates that are adequate to address the long-term liabilities of the system.

Cost-sharing

If gain-sharing is not really about sharing in "gains" or "profits," then why do we have gain-sharing? In the context of the Washington State Retirement Systems, gain-sharing is more about cost-sharing than profit sharing. When employer contribution rates are coming down, members with fixed contribution rates may receive benefit improvements in order to share in the reduced costs. Since such members are unable to experience reduced contribution rates based on variations in the market, they can receive benefits improvements of equivalent value.

Conversely, however, when employer contribution rates are going up, Plan 1 and Plan 3 members do not share in the increased costs (or experience plan "losses") for two reasons: first, their contribution rates are fixed, and secondly, as a general matter, permanent benefit increases cannot be subsequently reduced. Therefore, in the Plans 1 and 3, the employer covers all "losses" or increased costs. The contribution rates of Plan 2 members, on the other hand, are subject to increases to cover increased liabilities. Plan 2 members share in both reduced costs and increased costs.

Comparison with Other Retirement Systems

A review of the websites and handbooks for Washington's ten comparative retirement systems revealed three states that have adopted gain-sharing provisions: Colorado, Idaho and Minnesota. In addition, the Retirement Committee for the California Teachers' Association State Council had "gain-sharing ad hoc benefit for retirees" on its list of legislative priorities in 2000 and 2001, but it dropped off the list in 2002. Other systems outside Washington's comparative systems that have enacted gain-sharing (or similar) provisions include Arizona, Louisiana and New York City. The approaches of these systems differ considerably. The following discussion summarizes the gain-sharing experience in several jurisdictions.

Arizona

Arizona passed legislation creating a "Permanent Benefit Increase (PBI) COLA for retirees of the Arizona State Retirement System. Under the PBI, a portion of the investment returns, as measured on the actuarial value of assets, that exceeds 8% is "used" for retiree COLAs. If the retiree liability is one-third of the total liability, then one-third of the excess is "available" for the PBI. The retiree COLA's are paid whenever there is enough "set aside" to fund them. An enhanced PBI COLA is paid to those who retired with a minimum of ten years of service credit and have been retired for five or more years. The intent of the enhanced PBI is to help offset the cumulative effects of inflation since retirement.

The retirement system built up a large reserve in the late 1990's and has been paying 4% COLAs to most retirees since then. However more recently, due to poor investment returns, it is estimated that the reserve will be depleted within the next couple of years. At that point, no COLAs will be given until actuarial returns exceed 8% again. The cost of these benefit increases (COLAs) is added to the existing liabilities of the retirement system. There is no direct recognition of the PBI feature in the actuarial assumptions.

Colorado

Gain-sharing for members of Colorado's Public Employees' Retirement Association (PERA) was designed to allow employees and retirees to share benefits when the retirement plan is over-funded. 50% of over-funding went to active members in the form of a match to contributions to the 401(k) optional plan or to some other employer-sponsored tax-sheltered vehicle. The "Matchmaker" program for active members involved a dollar-for-dollar match of up to 1% of pay. Gain-sharing was also distributed to retirees as a contribution to the heath care trust fund where it could be used to finance increases in a health care subsidy provided to retirees. Matchmaker was suspended by the legislature this year. The Colorado legislature also reduced contributions to the health care trust this year by .08%. Coincidently, the legislature has adopted a plan to gradually increase employer contributions from 9.9% to 12.9% in 2012.

Idaho

The Public Employee Retirement System of Idaho (PERSI) adopted a gain-sharing program in 2000. As part of the program, PERSI established the Choice Plan, a defined contribution (DC) plan for active members. Gain-sharing distributions to active members would be deposited into their DC accounts and retirees would receive a 13th check. PERSI paid a gain-sharing distribution of $155 million to members, retirees and employers in 2001. State employers, however, were directed to return 80% of gain-sharing to the state's general fund; 20% was to be used for training. Other employers used gain-sharing as they saw fit.

Today Idaho is in the process of increasing contribution rates. The increases are being phased in over a three- year period ending in 2006. These increases will bring contribution rates back to their 1997 levels.

Louisiana

Louisiana established an "experience account" to be credited with 50% of the retirement system's net investment experience gain and debited for 50% of the system's net investment losses for each year. The retirement board was required to grant cost-of-living adjustments (COLAs) when the experience balance was sufficient to fund the COLA in full.

The State of Louisiana's Legislative Actuary recommended that the experience account be viewed merely as a temporary holding account, emphasizing that "**it does not fund** COLA benefits." That is because the earnings held in the account are needed to meet the actuarial assumed long-term average return. He asserted that the experience account was just a measuring device that the state could use to grant COLAs.

As explained by Louisiana's actuary, COLAs create an additional benefit liability that increases the unfunded accrued liability. He also pointed out that the key to ultimately achieving the expected return is that all investment income is credited to the asset base from which it is derived. If income is diverted for other purposes the assumed rate will not be achieved. This in turn destroys the required match between future benefit payments and assets available to pay for them. For that reason, the Actuary recommended that additional contributions be made to restore the funding balance between future assets and liabilities, and that contribution rates be independent of the experience account's "interference." See State of Louisiana Legislative Audit, July 2002. The estimated cost of "pre-funding" the Louisiana COLAs was approximately $2.2 billion for teachers and state employees.

Minnesota

The Minnesota State Retirement System (MSRS) currently provides two types of post-retirement adjustments: 1) a cost-of-living adjustment and 2) an investment performance component. Minnesota's gain-sharing is triggered when investment gains averaged over a five-year period exceed a specified amount - that is, the amount to cover the cost-of -living adjustment increase and the 6% return required to pay for the base benefit. This means that the cost-of-living component is pre-funded but the investment component is not.

According to the MSRS Handbook, the Minnesota's gain-sharing mechanism resulted, on average, in about a 7% increase in monthly benefits each year over the last 12 years. Now Minnesota reports problems since markets have fallen. It is expected that future post-retirement increases from the investment component will be substantially lower than those paid over the last few years. The increases for the next several years are projected to likely match inflation, up to 2.5%. Minnesota's Member Handbook states: "Unless the stock market rebounds dramatically, there will not be an investment component [to provide for increases after retirement]."

New York City

The New York City Employees' Retirement System (NYCERS) experimented with a gain-sharing mechanism referred to as "skimming" in order to improve retirement benefits for corrections officers. The benefit was to be funded with a portion of the earnings generated through NYCERS' equity investments. Excess earnings would be "skimmed" and put into a separate fund. The assets and earnings of this separate fund would be used to pay for the additional retirement benefits. In effect, excess earnings were moved from one "pot" to another, effecting a "cap" on earnings. As discussed earlier in this paper, a cap on earnings increases the need for higher contributions in the future.

When skimming was first proposed, there was some debate about the fiscal impact of skimming. The city's chief actuary estimated that the plan could cost $68-130 million annually in increased pension contributions using a net present value approach that discounted all future added benefits plus foregone investment income to its present value. The City Council estimated a cost of $6 million in 2000 rising to $75 million by 2009, and continuing to increase thereafter, using a "pay-as-you-go" approach that reflected the costs of the skim as they would occur on a year to year basis. That is, the city's contribution would not reflect any of the cost of expected future payments or NYCERS earnings foregone as a result of those payments.

Skimming passed, but was later repealed and replaced with a benefit of equivalent value.

Conclusion

Gain-sharing is a mechanism for triggering benefit enhancements. It is not a funding mechanism. The benefits that are distributed when there is a gain-sharing event are part of the liabilities of the affected pension plans and must be paid for just like any other benefit enhancement. Gain-sharing was initiated in response to the favorable market conditions of the late 1990's. Since the extraordinary gains of that period were spent for benefit enhancements, those gains were not available to offset the market losses that followed. Thus future contribution rate increases must respond not only to recent market losses, but also to the ongoing liabilities for benefit enhancements associated with gain-sharing events.

Gain-sharing experience over last five years has not been consistent with its original goals, nor is it consistent with the current policies codified in the actuarial funding chapter. The gain-sharing program is founded on a “pay-as-you-go” philosophy, while long-term funding objectives for the retirement systems at large utilize systematic actuarial pre-funding.

Gain-Sharing

Laura C. Harper
Senior Research Analyst/Legal

Select Committee on Pension Policy
August 17, 2004

Gain-Sharing

- Gain-sharing is a program for improving benefits in Plans 1 and 3.
- Improvements occur only when there are "extraordinary investment gains."

"Extraordinary Investment Gains"

- By definition, these gains occur when the compound average of investment returns on pension assets exceeds 10%.

- Look at previous four state fiscal years.

Gain-Sharing Distribution

- By statute, amount equal to one-half of extraordinary gains is distributed to eligible participants in Plans 1 and 3.

- In past, distributions paid for through adjustment to employer contribution rate.

Timing

- Gain-sharing calculations are made once each biennium.
- Potential distributions occur in January of even-numbered years.

Benefits

- Plan 1 retirees receive permanent boost to annual increase amount used to calculate the Uniform COLA.

- In Plans 3, active, term-vested and retired members receive lump sum deposits into DC accounts.

Benefits Distribution History

7/1/1998	$ 318 million
1/1/2000	$ 783 million
TOTAL:	$ 1.1 billion

Future Distributions

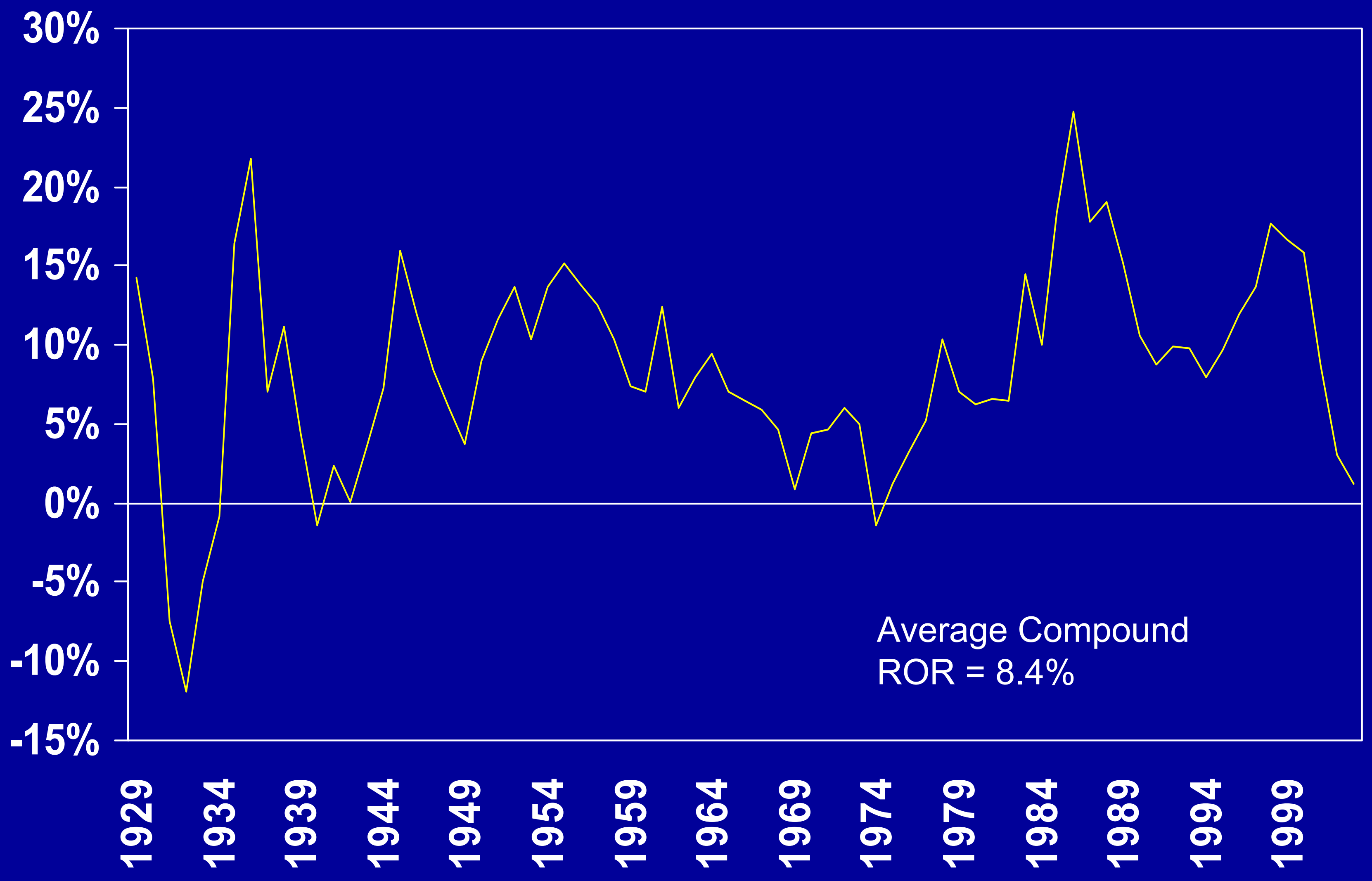
- Timing is unknown; will occur whenever market generates extraordinary gains.

- No designated funding source for future distributions.

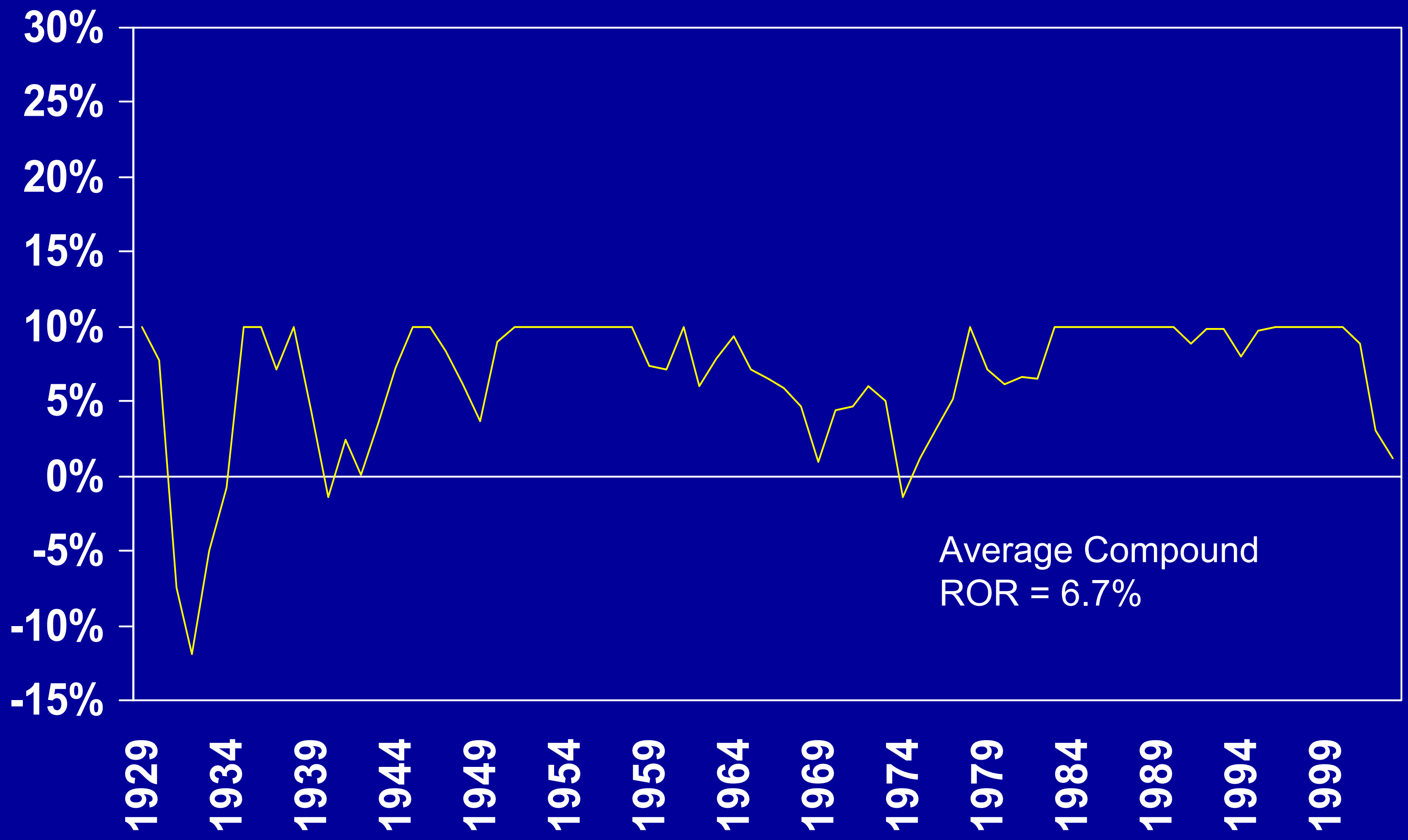
Future Cost

- Represents a material liability of the Plans 1 and 3.
- Actuarial Standards of Practice require pre-funding of material liabilities.
- Estimated cost is over $6 billion for 2005-2030.

Investment Rate of Return by Current Asset Mix: 1929 - 2003 4-Year Averages



Investment Rate of Return by Current Asset Mix: 1929 - 2003 4-Year Averages



Gain-Sharing Goals

Goal #1: *An ongoing process that is understandable, stable and would take place with meaningful frequency.*

- "No contract" clause
- Market volatility

Gain-sharing Goals

Goal #2: *No additional unfunded long-term liabilities.*

– No adjustment to supplemental rate
– No provision to fund future cost

Gain-Sharing Goals

Goal #3: *Immediate benefit improvements funded by recent investment gains.*

- – COLA increases
- – DC plan increases
- – Funded by employer contributions

Gain-Sharing Goals

Goal #4: *Future benefit improvements whenever assets invested in the retirement trust accounts experience extraordinary gains.*

- Future increases mandated.
- Market events trigger distributions.
- Incidence unknown.

Gain-Sharing Goals

Goal #5: *An acceleration of the date for paying off the unfunded liability of PERS Plan 1 and TRS Plan 1.*

– Amortization period shortened in 1998 and 2000.
– Since 2001, amortization period is back to 2024 (same as before gain-sharing).

Actuarial Funding Goals

1. ***To continue to fully fund the Plans 2 and 3.***

   No funding source is currently identified for future gain-sharing in Plan 3.

Actuarial Funding Goals

2. ***To fully amortize the total costs of the Plans 1 by 2024.***

   – Currently there is no requirement that gain-sharing be used to reduce the unfunded liability of the Plans 1.
   – Future benefit enhancements under gain-sharing will increase Plan 1 liabilities.

Actuarial Funding Goals

3. ***To establish predictable long-term employer contribution rates which will remain a relatively constant proportion of future budgets.***

   – If future is like past, gain-sharing benefits will be funded by ad hoc adjustments to employer contribution rate.

Actuarial Funding Goals

4. ***To fund benefit increases over the working lives of members so the cost of those benefits are paid by the taxpayers who receive the benefit of those members' service.***

   – Due to market volatility, some generations of taxpayers may be benefited or burdened more than others.

Parity Among Plans

The state shall provide similar benefits whenever possible.

- Plans 2 - do not receive gain-sharing distributions.
- Plans 1 - permanent increases in COLA.
- Plans 3 - lump sum payments.

Private Sector Model

Profit-sharing allows employee bonuses when profits exceed target.

– Public sector not-for-profit.
– Actuarial funding processes are long-term, not pay-as-you-go.

Federal Law Constraints

Minimum Distribution Rules restrict increasing benefits.

- Gain-sharing permissible.
- Specific requirements for measuring gains.
- Should be reviewed by tax counsel.

Comparative Systems

Colorado has used 50% of “over-funding” to match 401(k) contributions and to contribute to health care trust fund.

- “Matchmaker” suspended by legislature in 2004.
- Contributions to health care trust reduced by .08%.

Comparative Systems

Idaho established a gain-sharing program wherein distributions to actives are made to DC account and retirees receive 13th check.

- One distribution of $155 million in 2001.
- Contribution rates increasing to pre-1997 levels.

Comparative Systems

Minnesota has two COLAs: one that is pre-funded and one based on investment returns.

– Handbook currently cautions that unless the stock market rebounds dramatically, there will not be an investment component to COLAs.

Other Retirement Systems

Arizona has an "enhanced permanent benefit (PBI) COLA" funded by actuarial returns in excess of 8%

– Reserves almost depleted by investment losses.
– When depleted, no COLAs will be given until actuarial returns exceed 8% again.

Other Retirement Systems

Louisiana established an "experience account" funded by investment gains to fund COLAs.

– In 2002, the estimated cost to pre-fund the COLAs was $2.2 billion for teachers and state employees.

Other Retirement Systems

New York City established "skimming." Cost debate shows difference between pay-as-you-go approach and pre-funding the benefits.

– Skimming was repealed and replaced with a benefit of equal value.

Conclusion

- Gain-sharing triggers benefit enhancements with a material cost.
- Gain-sharing is not a funding mechanism.
- Future contribution rate increases must respond not only to recent market losses, but also to ongoing liabilities associated with gain-sharing events.

Conclusion

- The gain-sharing program experience over the last 5 years has been inconsistent with original program goals.
- The current “pay-as-you-go” approach to funding gain-sharing is inconsistent with long-term funding objectives.

Purchasing Power Options

(August 13, 2004)

Issue

The loss of purchasing power is a phenomenon that occurs when an income stream does not adjust to increases in consumer prices – a fixed retirement benefit being an appropriate illustration. There are three major issues in this regard: first, allowing those who have been retired for extended periods regain a portion of their lost purchasing power; second, maintaining at least that level; and third, assuring that those who've retired recently and those who retire in the future will not be subject to such losses.

Staff

Robert Wm. Baker, Senior Research Analyst
360-586-9237

Members Impacted

This issue primarily impacts Public Employees' Retirement System plan 1 (PERS 1) and Teachers' Retirement System plan 1 (TRS 1) members. As of the most recent valuation, there were 21,737 active and 54,006 retired PERS 1 members, and 12,456 active and 33,148 retired TRS 1 members.

Current Situation

Currently, the purchasing power of PERS 1 and TRS 1 benefits is partially protected by the Uniform Increase they receive on July 1st of each year after one year of retirement and after age 66. The Uniform increase is a dollar amount multiplied by the members' total years of service; that product is added to a member's monthly benefit. As of July 1, 2004, the Uniform Increase Amount was $1.21; a retiree who was at least age 66 with 30 years of service will be receiving a monthly increase of $36.30. The Uniform Increase Amount increases each year by at least 3%. When gain-sharing is available, distributions are made by enhancing the Uniform Increase amount and thus the Uniform COLA.

Funding: Ad Hoc vs. Permanent

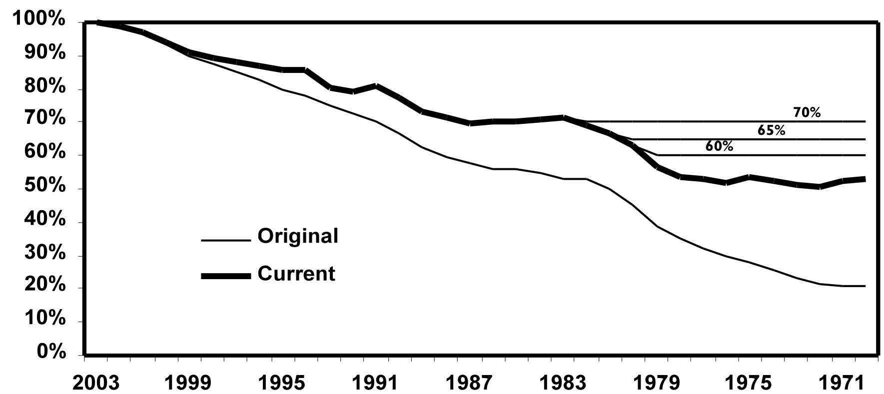
There are differing funding mechanisms if a benefit increase is ad hoc or permanent. An ad hoc benefit is a one-time increase that must be funded in the year in which it is given [RCW 41.45.070(5)] – akin to pay-as-you-go. In general, benefit increases to inactive members would tend to be ad hoc – active members would not tend to be effectively eligible for whatever benefit had been granted. A permanent benefit increase tends to be prospective, though not exclusively, with all active members, and sometimes retirees, receiving the benefit; and employer contribution rates will increase to pay for the benefit. Because of the funding method in PERS 1 and TRS 1, permanent benefit increases are rolled into each plan's unfunded actuarially accrued liability (UAAL) – this is similar to an individual taking out a second mortgage – and funded through the amortization date (June 30, 2024).

Options to Recover and Maintain Purchasing Power

These options fall into two broad groups -- those that will result in recovery of lost purchasing power, and those that will maintain purchasing power. Options 1-4 would allow those who have been retired for extended periods recover a portion of their lost purchasing power. Though all retirees will eventually receive the Uniform COLA, only those with long service and relatively small allowances are able to recover some of their lost purchasing power through receipt of the Uniform COLA. Options 5-9 are more conceptual in nature; they would allow current and future retirees to maintain their purchasing power. While many retirees are at least able to maintain their purchasing power from the point at which they became eligible for the Uniform COLA, the loss of purchasing power prior to receipt of the COLA is normally quite substantial for those who retire prior to age 60.

Option 1: **Establish a permanent minimum purchasing power floor under which retirees could not fall**. Several comparative systems – CalPERS, CalSTRS, Seattle City Employees Retirement System – use these kinds of provisions. That floor could be set at 60%, 65%, or 70% of the original benefit's purchasing power (see Figure 1). Because these purchasing power losses are based on the timing of a member's retirement, the effect would be to boost the allowance of those retired prior to a specific date. For instance, PERS members whose benefit is less than 60% of its original purchasing power retired prior to 1980; this is about 9,400 retirees. TRS members whose benefit is currently less than 60% of its original purchasing power retired prior to 1981; about 6,300 retirees.

Figure 1
Purchasing Power of PERS 1 Benefits with 60%, 65%, and 70% Floors



This would initially appear to be an ad hoc benefit -- a one-time bump-up with future allowances protected by the Uniform COLA. However, for retirees with less than 20 years of service, the Uniform COLA may not keep up with projected inflation. As a result, the funding would need to be permanent. This option would have a significant actuarial cost and a high administrative impact for the Department of Retirement Systems (the Department).

While the Uniform COLA provides some degree of protection from inflation, as per existing retirement system policy, this option would enhance that policy to set a minimum purchasing power floor. The 60% floor would also increase the current unfunded liability by $1,720 million. Any retroactive benefit increase may be in conflict with the policy to fund benefits over members' working lives.

Estimated Fiscal Impact of Establishing a Benefit Purchasing Power Floor

	% of Original Purchasing Power					
	60%		65%		70%	
($ in millions)	PERS	TRS	PERS	TRS	PERS	TRS
Increase in Unfunded Actuarial Accrued Liability (UAAL)	$980	$740	$1,390	$1,060	$1,880	$1,460
Increase in Employer Contribution Rate	0.70%	1.31%	0.99%	1.88%	1.35%	2.58%
General Fund						
1st Biennium	$31.2	$80.0	$44.1	$114.7	$60.2	$157.4
25 Year	$555.0	$1,388.0	$786.0	$1,992.3	$1071.1	$2,733.6
Non-General Fund						
1st Biennium	$35.1	$0.0	$49.7	$0.0	$67.9	$0.0
25 Year	$612.5	$0.0	$866.4	$0.0	$1181.6	$0.0
Local Government						
1st Biennium	$58.9	$16.3	$83.2	$23.5	$113.6	$32.2
25 Year	$1,035.3	$284.1	$1,464.6	$407.5	$1,997.9	$559.6

Option 2: **Enhance the Uniform COLA by boosting the Annual Increase Amount** to provide greater purchasing power protection for recent retirees and recovery of purchasing power for earlier retirees. The Annual Increase Amount is currently $1.21; each July 1, it increases by 3% plus any gain-sharing distributions. One proposal was to increase it to $1.50 or $2.00. Because the Annual Increase Amount goes up each year and would eventually reach those levels, this proposal provides a permanent early increase for eligible retirees. This option would have an actuarial cost and a low administrative impact for the Department.

While the Uniform COLA provides some degree of protection from inflation, as per existing retirement system policy, this option would still be in accordance with that policy and simply provide an early increase in the Uniform COLA amount. It would also increase the current unfunded liability by $200 million. This would be a retroactive benefit increase and may be in conflict with the policy to fund benefits over members' working lives.

Estimated Fiscal Impact of Increasing the Annual Increase Amount by 10¢

($ in millions)	PERS	TRS	TOTAL
Increase in Unfunded Actuarial Accrued Liability (UAAL)	$110	$90	$200
Increase in Employer Contribution Rate	0.08%	0.17%	
General Fund			
1st Biennium	$3.6	$10.3	$13.9
25 Year	$63.2	$180.0	$243.2
Non-General Fund			
1st Biennium	$4.0	$0.0	$4.0
25 Year	$69.7	$0.0	$69.7
Local Government			
1st Biennium	$6.6	$2.0	$8.6
25 Year	$117.9	$36.3	$154.2

Option 3: Increase the yearly multiplier for the Annual Increase Amount. Currently the Annual Increase Amount increases by at least 3% per year. Since the actuarial inflation assumption is 3.5% per year, the multiplier for the Annual Increase Amount could be raised to 3.5% per year or higher (see Figure 2). Changing the adjustment factor would provide greater purchasing power protection for long service, low benefit retirees. This option would have a modest actuarial cost and a low administrative impact on the Department.

Figure 2
Yearly Multiplier for the Annual Increase Amount and Monthly Benefit for a Retiree with 20 Years of Service

		2004	2005	2006	2007	2008	2009	2010	2011
3.0%	Amount	$1.21	$1.25	$1.29	$1.33	$1.37	$1.41	$1.45	$1.49
	Benefit	$24.20	$25.00	$25.80	$26.60	$27.40	$28.20	$29.00	$29.80
3.5%	Amount	$1.21	$1.25	$1.30	$1.34	$1.39	$1.44	$1.49	$1.54
	Benefit	$24.20	$25.00	$26.00	$26.80	$27.80	$28.80	$29.80	$30.80
4.0%	Amount	$1.21	$1.26	$1.31	$1.36	$1.42	$1.47	$1.53	$1.59
	Benefit	$24.20	$25.20	$26.20	$27.20	$28.40	$29.40	$30.60	$31.80

While the Uniform COLA provides some degree of protection from inflation, as per existing retirement system policy, this option would still be in accordance with that policy and simply align the adjustment to the Annual Increase Amount with the current actuarial inflation assumption. The 3.5% multiplier would also increase the current unfunded liability by $150 million. As this would be a retroactive benefit increase it may be in conflict with the policy to fund benefits over members' working lives.

Estimated Fiscal Impact of Increasing the Multiplier for the Annual Increase Amount

	3.5%		4.0%	
($ in millions)	**PERS**	**TRS**	**PERS**	**TRS**
Increase in Unfunded Actuarial Accrued Liability (UAAL)	$80	$70	$170	$150
Increase in Employer Contribution Rate	0.06%	0.13%	0.12%	0.26%
General Fund				
1st Biennium	$2.6	$8.0	$5.3	$15.9
25 Year	$47.2	$137.8	$94.6	$275.4
Non-General Fund				
1st Biennium	$3.0	$0.0	$5.9	$0.0
25 Year	$52.4	$0.0	$105.0	$0.0
Local Government				
1st Biennium	$5.0	$1.6	$10.1	$3.4
25 Year	$88.0	$28.0	$177.2	$56.2

Option 4: Increase the $1,000 alternative minimum benefit by 3% per year. This would change an ad hoc benefit into a permanent benefit. The current minimum benefit is $32.97 per month per year of service, and it increases each year by the Annual Increase Amount. At the latest, the minimum benefit will reach $41.07 in 2010, thus surpassing the $1,000 alternative minimum for a member with 25 years of service. By increasing the $1,000 alternative minimum benefit by 3% per year, eligible retirees will be more able to retain that level of purchasing power. This option would have a modest actuarial cost and a low administrative impact on the Department.

While the Alternative Minimum Benefit provides some degree of protection from inflation, as per existing retirement system policy, this option would still be in accordance with that policy and simply change it from an ad hoc benefit to a permanent benefit. It would also increase the current unfunded liability by $11 million. Any retroactive benefit increase may be in conflict with the policy to fund benefits over members' working lives.

Estimated Fiscal Impact of Making the $1,000 Minimum a Permanent Benefit that Increases by 3% per Year

($ in millions)	PERS	TRS	TOTAL
Increase in Unfunded Actuarial Accrued Liability (UAAL)	$7	$4	$11
Increase in Employer Contribution Rate	0.01%	0.01%	
General Fund			
1st Biennium	$0.4	$0.5	$0.9
25 Year	$7.7	$10.5	$18.2
Non-General Fund			
1st Biennium	$0.5	$0.0	$0.5
25 Year	$8.7	$0.0	$8.7
Local Government			
1st Biennium	$0.8	$0.1	$0.9
25 Year	$14.5	$2.1	$16.6

Summary of Proposals to Recover Purchasing Power: Options 1 through 4

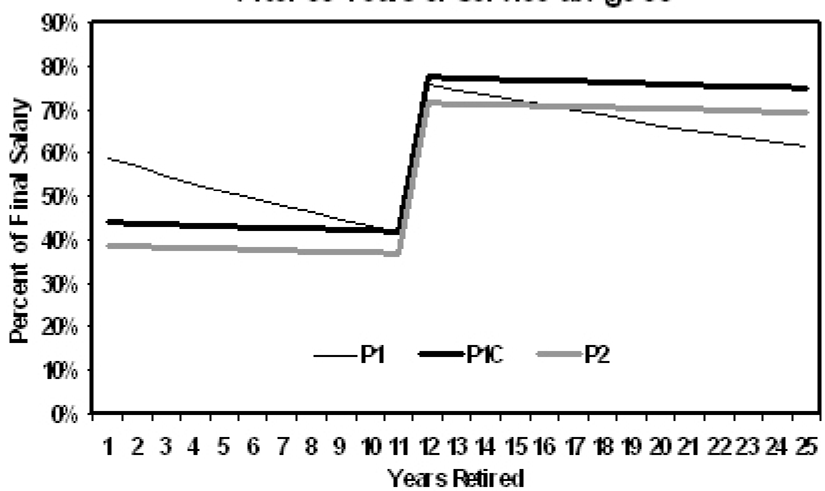
($ in millions) Title	1st Biennium Cost	Administrative Impact
1. 60% Benefit Floor	$221.5	High
1. 65% Benefit Floor	$315.2	High
1. 70% Benefit Floor	$431.3	High
2. Annual Increase Amount to 10¢	$26.5	Low
3. Annual Increase Multiplier to 3.5%	$20.2	Low
3. Annual Increase Multiplier by 4.0%	$40.6	Low
4. Increase $1,000 minimum 3% per year	$2.3	Low

Maintaining Purchasing Power

The following proposals to maintain purchasing power are more conceptual than the first four. It is apparent that the recovery of lost purchasing power is costly. It may, therefore, be appropriate to engage in preventative measures so that future retirees are not subject to extended periods where they receive no inflation adjustment to their retirement benefit.

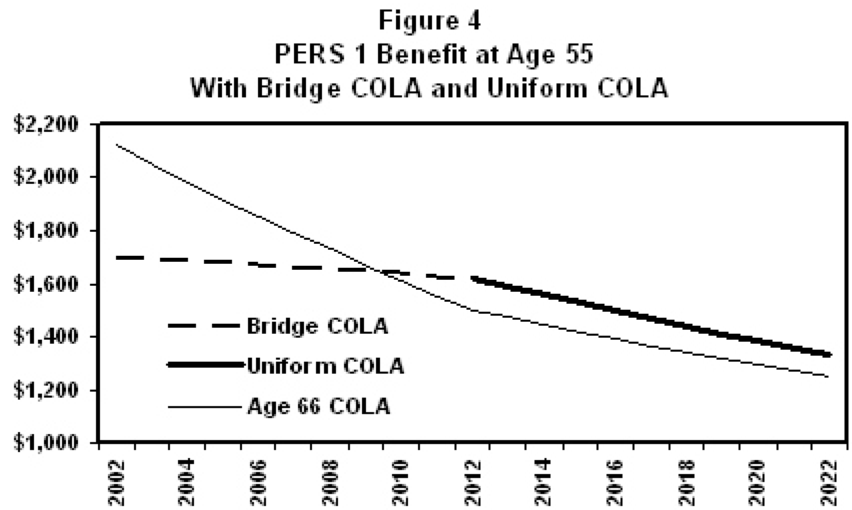
Option 5: **Make the current Plan 1 COLA Payment Option the default** during retirement calculations and the option would then be to refuse the COLA. At the same time, provide PERS 1 and TRS 1 members a higher level of education on the ramifications of opting out of the COLA; use of illustrations like Figure 3 to explain the advantages of the COLA option may result in greater utilization. This option would have no actuarial impact, but would have a medium administrative impact for the Department.

Figure 3
PERS Optional COLA & SSI Benefits as a % of Final Pay
After 30 Years of Service at Age 55



It is unlikely that this provision would be in conflict with existing retirement policies as it neither changes nor diminishes members' benefits.

Option 6: **Offer a "Bridge COLA" for those PERS 1 and TRS 1 members retiring before age 65** that sunsets when members become eligible for the Uniform COLA. A member could choose an actuarially equivalent 1.5%, 2.0%, or 3% optional COLA payment for however many years until the member becomes Uniform COLA eligible (see Figure 4). This option would have no actuarial impact, but would have a high administrative impact for the Department.



While the Uniform COLA provides some degree of protection from inflation, as per existing retirement system policy, this option would still be in accordance with that policy and allow further purchasing power protection for those retiring several years before being eligible for the Uniform COLA.

Option 7: **Modify the Plan 1 COLA Payment Option**. The benefit of PERS 1 and TRS 1 members who chose the 3% COLA payment option upon retirement is actuarially reduced. Allow members to chose a 2% or 1.5% COLA payment option. The actuarial factors vary by age – younger retirees experience a greater reduction; the initial benefit of an age 55 retiree is reduced by about 25% should they choose the 3% COLA option. By offering a 1.5% COLA option, for example, the reduction in the initial benefit would be about half the reduction of the 3% COLA option, (see Figures 5 and 6). This option would have no actuarial impact, but would have a high administrative impact for the Department.

Figure 5
PERS 1 Actuarial Factors for Various COLA Payment Options at Select Retirement Ages

	COLA Payment Options		
	3.0%	**2.0%**	**1.5%**
Age 55	0.7510	0.8310	0.8722
Age 60	0.7731	0.8462	0.8837
Age 65	0.7972	0.8627	0.8963

Figure 6
Adjusted PERS Benefits at Select Ages by COLA Payment Options: Average Benefit = $2122

	COLA Payment Options		
	3.0%	**2.0%**	**1.5%**
Age 55	$1,594	$1,763	$1,851
Age 60	$1,641	$1,796	$1,875
Age 65	$1,692	$1,831	$1,902

Option 8: **Modify the Plan 1 COLA Payment Option**. The benefit of PERS 1 and TRS 1 members who chose the COLA payment option upon retirement is actuarially reduced. By trading off the cost of the Uniform COLA, which includes gain-sharing, the actuarial impact for the 3% COLA payment option can be reduced. Because the Uniform COLA is based on service rather than average final compensation (AFC), it is of more value to members with long service and low benefits. As a result, the changes in actuarial factors would be based on both the member's service and AFC. This option would have no actuarial impact, but would have a medium administrative impact for the Department.

Option 9: **Subsidize the Plan 1 COLA Payment Option.** The benefit of PERS 1 and TRS 1 members who chose the COLA payment option upon retirement is actuarially reduced. As a result, those choosing this option pay for their own COLA. By providing an employer subsidy cost-sharing can be introduced, and the actuarial impact for the 3% COLA payment option can be reduced. This option would have an actuarial impact and a medium administrative impact for the Department.

Multiple Options

In order to respond to both the Purchasing Power issue and Adequacy of Benefits issue, and to simultaneously recover and maintain purchasing power, several of these options could be melded into one. This could be done, for example, by establishing the purchasing power floor below which retirees would not fall, and redesigning the PERS 1 and TRS 1 COLA provisions. In this manner, existing retiree purchasing power issues would be addressed and future retiree COLA issues would be eased. While the Uniform COLA and Annual Increase Amount are considered non-contractual, any revision to a material benefit must be undertaken with caution. In addition, the IRS recently released its latest Minimum Distribution regulations which have an impact on public sector COLAs, and any such modifications would likely need Tax Council review.

Purchasing Power Benefit Options

Robert Wm. Baker
Senior Research Analyst

Select Committee on Pension Policy
August 17, 2004

Purchasing Power

… the measure of how a benefit retains its value over time.

Purchasing Power Issues

- Regaining lost purchasing power
- Maintaining purchasing power
- Assure that current and future retirees not be subject to such losses

Members Impacted

- 21,737 active and 54,006 retired PERS 1 members
- 12,456 active and 33,148 retired TRS 1 members.

Uniform Increase

- $1.21 per month per year of service (July 1, 2004)
  – $36.30 per month for member w/30 yos
- Began in 1995 at $0.59
- Increases 3% per year
- Augmented by gain-sharing

History

- 1961 : $900 per year minimum for a member who retired at 70 years of age with 10 years of service
- 2004 : $1,000 per month minimum for a member retired at least 20 years after 25 years of service
- See Appendix A in July report

Current Efforts

- Increase frequency of gain-sharing to include odd-numbered years
- Lower threshold for determining when gain-sharing can occur.

Policy Constraints

"... fund benefit increases for plan members over the working lives of those members so that the cost of those benefits are paid by the taxpayers who receive the benefit of those members' service."

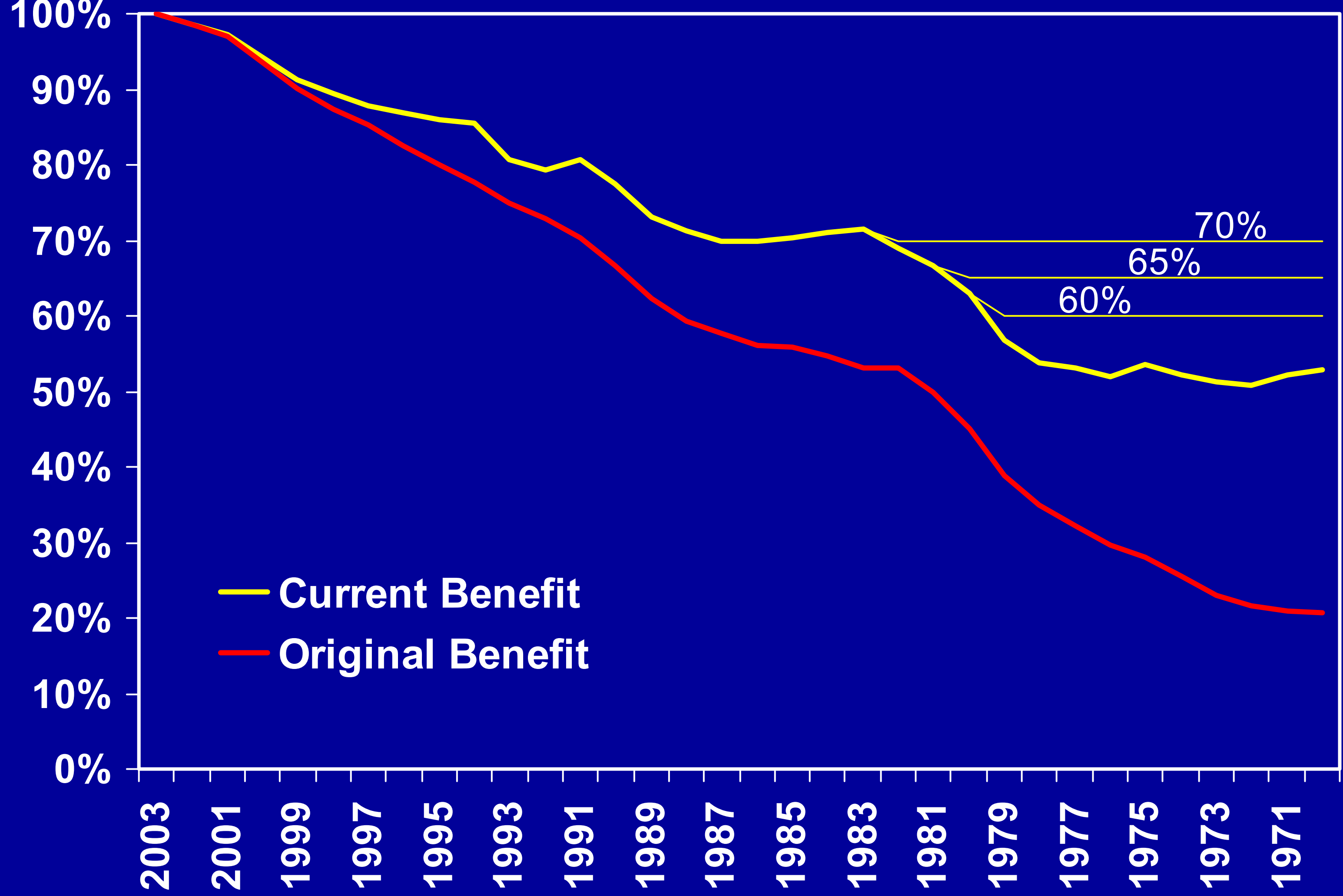
Option Groups

- 1 to 4: Recover lost purchasing power
- 5 to 9: Maintain purchasing power

Option 1

- Establish a minimum purchasing power floor under which members could not fall.
- The floor could be set at 60%, 65%, or 70% of the original benefit purchasing power.
- Actuarial cost & high administrative impact

Purchasing Power of PERS 1 Service Benefits in 2003 with Select Minimums



Estimated Fiscal Impact of Establishing a Benefit Purchasing Power Floor

		% of Original Purchasing Power					
		60%		65%		70%	
($ in millions)		PERS	TRS	PERS	TRS	PERS	TRS
Increase in UAAL		$980	$740	$1,390	$1,060	$1,880	$1,460
Increase in ER Rate		0.70%	1.31%	0.99%	1.88%	1.35%	2.58%
General Fund	1st Biennium	$31.2	$80.0	$44.1	$114.7	$60.2	$157.4
	25 Year	$555.0	$1,388.0	$786.0	$1,992.3	$1,071.1	$2,733.6
Non-general Fund	1st Biennium	$35.1	$0.0	$49.7	$0.0	$67.9	$0.0
	25 Year	$612.5	$0.0	$866.4	$0.0	$1,181.6	$0.0
Local Government	1st Biennium	$58.9	$16.3	$83.2	$23.5	$113.6	$32.2
	25 Year	$1,035.3	$284.1	$1,464.6	$407.5	$1,997.9	$559.6

Option 2

- Enhance Uniform COLA by boosting the Annual Increase Amount
- Currently $1.21 – Set to $1.50 or $2.00
- Actuarial cost & low administrative impact

Estimated Fiscal Impact of Increasing the Annual Increase Amount by 10¢

($ in millions)		PERS	TRS
Increase in UAAL		$110	$92
Increase in ER Rate		0.08%	0.17%
General Fund	1st Biennium	$3.6	$10.3
	25 Year	$63.2	$180.0
Non-general Fund	1st Biennium	$4.0	$0.0
	25 Year	$69.7	$0.0
Local Government	1st Biennium	$6.6	$2.0
	25 Year	$117.9	$36.3

Option 3

- Increase the yearly multiplier to the Annual Increase Amount
- Currently 3% per year – change to 3.5% or 4.0% per year
- Actuarial cost & low administrative impact

Monthly Benefit for a Retiree with 20 Years of Service by Various Annual Increase Amounts

		2004	2011
3.0%	Amount	$1.21	$1.49
	Benefit	$24.20	$29.80
3.5%	Amount	$1.21	$1.54
	Benefit	$24.20	$30.80
4.0%	Amount	$1.21	$1.59
	Benefit	$24.20	$31.80

Estimated Fiscal Impact of Increasing the Multiplier for the Annual Increase Amount

		3.5%		4.0%	
($ in millions)		PERS	TRS	PERS	TRS
Increase in UAAL		$80	$70	$168	$147
Increase in ER Rate		0.06%	0.16%	0.12%	0.26%
General Fund	1st Biennium	$2.6	$8.0	$5.3	$15.9
	25 Year	$47.2	$137.8	$94.6	$275.4
Non-general Fund	1st Biennium	$3.0	$0.0	$5.9	$0.0
	25 Year	$52.4	$0.0	$105.0	$0.0
Local Government	1st Biennium	$5.0	$1.6	$10.1	$3.4
	25 Year	$88.0	$28.0	$177.2	$56.2

Option 4

- Increase the $1,000 alternative minimum by 3% per year
- Currently minimum ($32.97) increases 3% per year
- Actuarial cost & low administrative impact

Estimated Fiscal Impact of Increasing the $1,000 Minimum Benefit by 3% Per Year

($ in millions)		PERS	TRS
Increase in UAAL		$7	$4
Increase in ER Rate		0.01%	0.01%
General Fund	1st Biennium	$0.4	$0.5
	25 Year	$7.7	$10.5
Non-general Fund	1st Biennium	$0.5	$0.0
	25 Year	$8.7	$0.0
Local Government	1st Biennium	$0.8	$0.1
	25 Year	$14.5	$2.1

Summary of Proposals: Options 1 – 4

($ in millions)

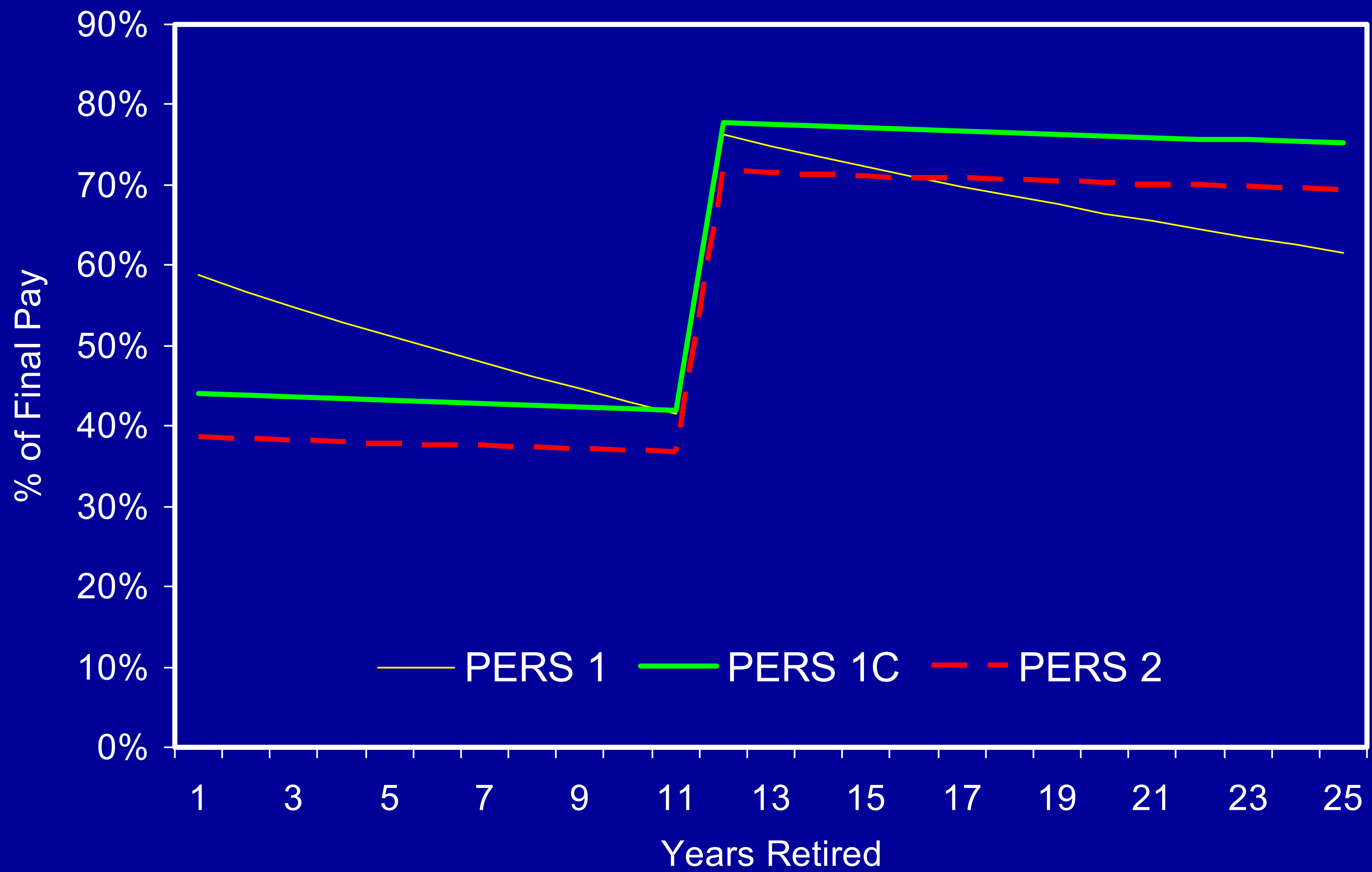
Option / Title	1st Biennium Cost	Administrative Impact
1. 60% Benefit Floor	$221.5	High
1. 65% Benefit Floor	$315.2	High
1. 70% Benefit Floor	$431.3	High
2. Annual Increase Amount by 10¢	$26.5	Low
3. Annual Increase Multiplier to 3.5%	$20.2	Low
3. Annual Increase Multiplier to 4.0%	$40.6	Low
4. Increase $1,000 minimum 3% per year	$2.3	Low

Maintaining Purchasing Power Options

Option 5

- Make the 3% COLA payment the default – require retirees to opt out
- Higher level of education on ramifications of not taking the COLA
- No actuarial cost & medium administrative impact

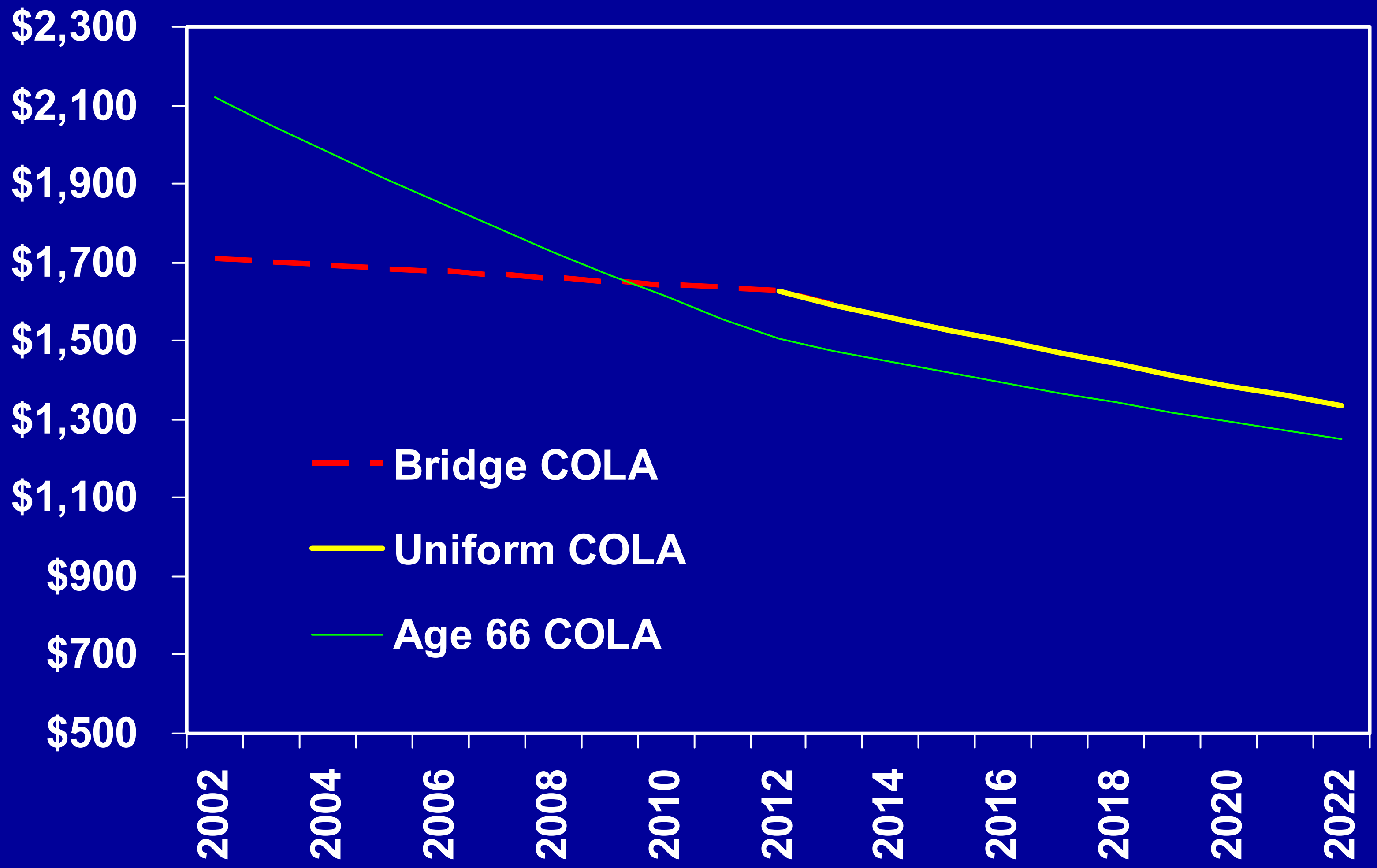
PERS Optional COLA & SSI Benefits as a % of Final Pay After 30 Years of Service at Age 55



Option 6

- Offer an optional “Bridge COLA” that sunsets upon receipt of Uniform COLA
- Actuarially equivalent 1.5%, 2.0%, or 3.0% COLA
- No actuarial cost & high administrative impact

PERS 1 Benefit at Age 55
With Bridge COLA and Uniform COLA



Option 7

- Modify the Plan 1 COLA Payment Option
- Offer 1.5%, 2.0%, or 3.0% COLA options
- No actuarial cost & high administrative impact

PERS 1 Actuarial Factors for Various COLA Payment Options at Select Ages

	COLA Payment Options		
	3.0%	2.0%	1.5%
Age 55	0.7510	0.8310	0.8722
Age 60	0.7731	0.8462	0.8837
Age 65	0.7972	0.8627	0.8963

Adjusted PERS 1 Benefits At Select Ages by COLA Payment Options:

Average Benefit = $2122

	COLA Payment Options		
	3.0%	2.0%	1.5%
Age 55	$1,594	$1,763	$1,851
Age 60	$1,641	$1,796	$1,875
Age 65	$1,692	$1,831	$1,902

Option 8

- Modify the Plan 1 COLA Payment Option
- Trade off the cost of the Uniform COLA (including gain-sharing) to reduce the actuarial impact
- No actuarial cost & medium administrative impact

Option 9

- Modify the Plan 1 COLA Payment Option
- Add an employer subsidy to reduce the actuarial impact
- Actuarial cost & medium administrative impact

Multiple Options

- Meld several options into one proposal
  - Purchasing power floor
  - Redesign Plan 1 COLA Payment option
- Address recovery and maintenance of purchasing power simultaneously
- Use caution when changing material benefits
- New IRS minimum distribution regulations

Pension Funding Council Audit and Recommendations

(August 9, 2004)

Issue The Select Committee on Pension Policy (SCPP) is required to study and make recommendations on changes to assumptions or contribution rates to the Pension Funding Council (PFC) prior to adoption of changes by the PFC.

Staff Matt Smith, State Actuary
360-753-9144

Council Membership

The PFC consists of the following members:

- Director of the Department of Retirement Systems;
- Director of the Office of Financial Management;
- Chair and ranking minority member of the house of representatives appropriations committee; and
- Chair and ranking minority member of the senate ways and means committee.

The PFC is supported by a work group consisting of one staff member from each of the following agencies or committees: Department of Retirement Systems, Office of Financial Management, State Investment Board, Senate Ways and Means Committee, House Appropriations Committee, and the Economic and Revenue Forecast Council.

Power and Duties

The PFC adopts changes to long-term economic assumptions, asset smoothing method and contribution rates. The council solicits and administers a biennial actuarial audit of the actuarial valuations used for rate-setting purposes and administers an actuarial audit of the results of the experience study required under RCW 41.45.090.

Any changes adopted by the PFC are subject to revision by the legislature.

Coordination with SCPP

Upon receipt of the results of the actuarial audits, the PFC submits the results to the SCPP. The SCPP studies and makes recommendations on changes to assumptions or contribution rates to the PFC prior to adoption of changes under RCW 41.45.030 (adoption of long-term economic assumptions), 41.45.035 (long-term economic assumptions and asset smoothing technique), or 41.45.060 (adoption of contribution rates).

Process Overview and Time Line

Beginning April 1, 2004, and every four years thereafter:

- the state actuary submits to the PFC information regarding the experience and financial condition of the state retirement systems (report attached).

By May 31, 2004, and every four years thereafter:

- the PFC may adopt changes to the long-term economic assumptions and asset smoothing technique (no changes were adopted in 2004).

By August 31, 2004, and every two years thereafter:

- the PFC receives the preliminary results of the actuarial audits and submits the results to the SCPP.

Not later than September 30, 2004, and every two years thereafter:

- the SCPP studies and makes recommendations to the PFC on changes to assumptions or contribution rates.
- the PFC adopts and may make changes to the basic employer and state contribution rates for PERS, TRS, SERS, LEOFF Plan 1 and WSP. The contribution rates are effective for the ensuing biennium subject to revision by the legislature.

2004 SCPP Action Items

- Receive the preliminary results of the actuarial audits (by August 31, 2004)
- Study and make recommendations to the PFC on changes to contribution rates (prior to adoption by the PFC in September).

The PFC did not adopt changes to the long-term economic assumptions or asset smoothing method. The statutory deadline to adopt such changes for this year's cycle was May 31, 2004. Therefore, the available period for the SCPP to provide recommendations to the PFC on assumptions and asset smoothing method has closed. The next statutory window for this review opens on April 1, 2008 and closes on May 31, 2008.

Preliminary Contribution Rates

System	Current Employer Rates	Preliminary Employer Rates for 05-07*
PERS	1.18%	5.49%
TRS	1.17%	6.51%
SERS	0.85%	7.27%
LEOFF 1	0.00%	0.00%
WSP	0.00%	4.35%

Excludes current administrative expense charge of 0.22%

** Unaudited results. Includes the cost of prefunding the liability for existing gain-sharing benefit provisions in PERS, TRS and SERS.*

System	Current Plan 2 Employee Rates	Preliminary Plan 2 Employee Rates for 05-07*
PERS	1.18%	3.25%
TRS	0.87%	2.48%
SERS	0.85%	3.51%
WSP (all actives)	2.00%	4.35%

The employee contribution rate in PERS and TRS Plan 1 is fixed at 6%. Plan 3 employees do not contribute to the defined benefit portion of their plan.

** Unaudited results.*

RCW 41.45.110
Pension funding council -- Audits required -- Select committee on pension policy.

The pension funding council shall solicit and administer a biennial actuarial audit of the actuarial valuations used for rate-setting purposes. This audit will be conducted concurrent with the actuarial valuation performed by the state actuary. At least once in each six-year period, the pension funding council shall solicit and administer an actuarial audit of the results of the experience study required in RCW 41.45.090. Upon receipt of the results of the actuarial audits required by this section, the pension funding council shall submit the results to the select committee on pension policy.

[2003 c 295 § 10; 1998 c 283 § 3.]

RCW 41.04.281
Select committee on pension policy -- Powers and duties.

The select committee on pension policy has the following powers and duties:

(1) Study pension issues, develop pension policies for public employees in state retirement systems, and make recommendations to the legislature;

(2) Study the financial condition of the state pension systems, develop funding policies, and make recommendations to the legislature;

(3) Consult with the chair and vice-chair on appointing members to the state actuary appointment committee upon the convening of the state actuary appointment committee established under RCW 44.44.013; and

(4) Receive the results of the actuarial audits of the actuarial valuations and experience studies administered by the pension funding council pursuant to RCW 41.45.110. The select committee on pension policy shall study and make recommendations on changes to assumptions or contribution rates to the pension funding council prior to adoption of changes under RCW 41.45.030, 41.45.035, or 41.45.060.

[2003 c 295 § 5.]

RCW 41.45.030
State actuary to submit information on the experience and financial condition of each retirement system -- Adoption of long-term economic assumptions.

(1) Beginning April 1, 2004, and every four years thereafter, the state actuary shall submit to the council information regarding the experience and financial condition of each state retirement system. The council shall review this and such other information as it may require.

(2) By May 31, 2004, and every four years thereafter, the council, by affirmative vote of four councilmembers, may adopt changes to the long-term economic assumptions established in RCW 41.45.035. Any changes adopted by the council shall be subject to revision by the legislature.

The council shall consult with the economic and revenue forecast supervisor and the executive director of the state investment board, and shall consider long-term historical averages, in reviewing possible changes to the economic assumptions.

(3) The assumptions and the asset value smoothing technique established in RCW 41.45.035, as modified in the future by the council or legislature, shall be used by the state actuary in conducting all actuarial studies of the state retirement systems, including actuarial fiscal notes under RCW 44.44.040. The assumptions shall also be used for the administration of benefits under the retirement plans listed in RCW 41.45.020, pursuant to timelines and conditions established by department rules.

[2001 2nd sp.s. c 11 § 5; 1995 c 233 § 1; 1993 c 519 § 17; 1989 c 273 § 3.]

NOTES:

Effective date -- 2001 2nd sp.s. c 11: "Except under section 21 of this act, this act is necessary for the immediate preservation of the public peace, health, or safety, or support of the state government and its existing public institutions, and takes effect July 1, 2001." [2001 2nd sp.s. c 11 § 22.]

Effective date -- 1995 c 233: "This act is necessary for the immediate preservation of the public peace, health, or safety, or support of the state government and its existing public institutions, and shall take effect immediately [May 5, 1995]." [1995 c 233 § 4.]

Part headings not law -- Effective date -- 1993 c 519: See notes following RCW 28A.400.212.

RCW 41.45.035
Long-term economic assumptions--Asset value smoothing technique.

(1) Beginning July 1, 2001, the following long-term economic assumptions shall be used by the state actuary for the purposes of RCW 41.45.030:

(a) The growth in inflation assumption shall be 3.5 percent;

(b) The growth in salaries assumption, exclusive of merit or longevity increases, shall be 4.5 percent;

(c) The investment rate of return assumption shall be 8 percent; and

(d) The growth in system membership assumption shall be 1.25 percent for the public employees' retirement system, the school employees' retirement system, and the law enforcement officers' and fire fighters' retirement system. The assumption shall be .90 percent for the teachers' retirement system.

(2)(a) Beginning with actuarial studies done after July 1, 2003, changes to plan asset values that vary from the long-term investment rate of return assumption shall be recognized in the actuarial value of assets over a period that varies up to eight years depending on the magnitude of the deviation of each year's investment rate of return relative to the long-term rate of return assumption. Beginning with actuarial studies performed after July 1, 2004, the actuarial value of assets shall not be greater than one hundred thirty percent of the market value of assets as of the valuation date or less than seventy percent of the market value of assets as of the valuation date. Beginning April 1, 2004, the council, by affirmative vote of four councilmembers, may adopt changes to this asset value smoothing technique. Any changes adopted by the council shall be subject to revision by the legislature.

(b) The state actuary shall periodically review the appropriateness of the asset smoothing method in this section and recommend changes to the legislature as necessary.

[2004 c 93 § 2; 2003 1st sp.s. c 11 § 1; 2001 2nd sp.s. c 11 § 6.]

NOTES:

Effective date -- 2003 1st sp.s. c 11: "This act is necessary for the immediate preservation of the public peace, health, or safety, or support of the state government and its existing public institutions, and takes effect July 1, 2003." [2003 1st sp.s. c 11 § 4.]

Effective date -- 2001 2nd sp.s. c 11: See note following RCW 41.45.030.

RCW 41.45.060
Basic state and employer contribution rates adopted by council. ***(Effective until July 1, 2006.)***

(1) The state actuary shall provide actuarial valuation results based on the economic assumptions and asset value smoothing technique included in RCW 41.45.035 or adopted by the council under RCW 41.45.030 or 41.45.035.

(2) Not later than September 30, 2002, and every two years thereafter, consistent with the economic assumptions and asset value smoothing technique included in RCW 41.45.035 or adopted under RCW 41.45.030 or 41.45.035, the council shall adopt and may make changes to:

(a) A basic state contribution rate for the law enforcement officers' and fire fighters' retirement system plan 1;

(b) Basic employer contribution rates for the public employees' retirement system, the teachers' retirement system, and the Washington state patrol retirement system to be used in the ensuing biennial period; and

(c) A basic employer contribution rate for the school employees' retirement system for funding both that system and the public employees' retirement system plan 1.

The contribution rates adopted by the council shall be subject to revision by the legislature.

(3) The employer and state contribution rates adopted by the council shall be the level percentages of pay that are needed:

(a) To fully amortize the total costs of the public employees' retirement system plan 1, the teachers' retirement system plan 1, and the law enforcement officers' and fire fighters' retirement system plan 1 not later than June 30, 2024; and

(b) To also continue to fully fund the public employees' retirement system plans 2 and 3, the teachers' retirement system plans 2 and 3, and the school employees' retirement system plans 2 and 3 in accordance with RCW 41.45.061, 41.45.067, and this section.

(4) The aggregate actuarial cost method shall be used to calculate a combined plan 2 and 3 employer contribution rate and a Washington state patrol retirement system contribution rate.

(5) The council shall immediately notify the directors of the office of financial management and department of retirement systems of the state and employer contribution rates adopted. The rates shall be effective for the ensuing biennial period, subject to any legislative modifications.

(6) The director of the department of retirement systems shall collect the rates established in *RCW 41.45.053 through June 30, 2003. Thereafter, the director shall collect those rates adopted by the council. The rates established in *RCW 41.45.053, or by the council, shall be subject to revision by the council.

[2003 c 294 § 10; 2003 c 92 § 3; 2002 c 26 § 2. Prior: 2001 2nd sp.s. c 11 § 10; 2001 c 329 § 10; 2000 2nd sp.s. c 1 § 905; 2000 c 247 § 504; prior: 1998 c 341 § 404; 1998 c 340 § 11; 1998 c 283 § 6; 1995 c 239 § 309; 1993 c 519 § 19; 1992 c 239 § 2; 1990 c 18 § 1; 1989 c 273 § 6.]

NOTES:

Reviser's note: *(1) RCW 41.45.053 was repealed by 2002 c 7 § 2. Compare provisions of RCW 41.45.054.

(2) This section was amended by 2003 c 92 § 3 and by 2003 c 294 § 10, each without reference to the other. Both amendments are incorporated in the publication of this section under RCW 1.12.025(2). For rule of construction, see RCW 1.12.025(1).

Severability -- Effective date -- 2003 c 92: See RCW 41.26.905 and 41.26.906.

Effective date -- 2001 2nd sp.s. c 11: See note following RCW 41.45.030.

Effective date -- 2001 c 329: See note following RCW 43.43.120.

Severability -- Effective date -- 2000 2nd sp.s. c 1: See notes following RCW 41.05.143.

Effective dates -- Subchapter headings not law -- 2000 c 247: See RCW 41.40.931 and 41.40.932.

Effective date -- 1998 c 341: See note following RCW 41.34.060.

Effective date -- 1998 c 340: See note following RCW 41.31.010.

Intent -- Purpose -- 1995 c 239: See note following RCW 41.32.831.

Effective date -- Part and subchapter headings not law -- 1995 c 239: See notes following RCW 41.32.005.

Part headings not law -- Effective date -- 1993 c 519: See notes following RCW 28A.400.212.

Effective date -- 1992 c 239: "This act shall take effect September 1, 1992." [1992 c 239 § 6.]

Effective date -- 1990 c 18: "This act shall take effect September 1, 1991." [1990 c 18 § 3.]

Benefits not contractual right until date specified: RCW 41.34.100.

RCW 41.45.060
Basic state and employer contribution rates adopted by council. ***(Effective July 1, 2006.)***

(1) The state actuary shall provide actuarial valuation results based on the economic assumptions and asset value smoothing technique included in RCW 41.45.035 or adopted by the council under RCW 41.45.030 or 41.45.035.

(2) Not later than September 30, 2002, and every two years thereafter, consistent with the economic assumptions and asset value smoothing technique included in RCW 41.45.035 or adopted under RCW 41.45.030 or 41.45.035, the council shall adopt and may make changes to:

(a) A basic state contribution rate for the law enforcement officers' and fire fighters' retirement system plan 1;

(b) Basic employer contribution rates for the public employees' retirement system, the teachers' retirement system, and the Washington state patrol retirement system to be used in the ensuing biennial period; and

(c) A basic employer contribution rate for the school employees' retirement system and the public safety employees' retirement system for funding both those systems and the public employees' retirement system plan 1.

The contribution rates adopted by the council shall be subject to revision by the legislature.

(3) The employer and state contribution rates adopted by the council shall be the level percentages of pay that are needed:

(a) To fully amortize the total costs of the public employees' retirement system plan 1, the teachers' retirement system plan 1, and the law enforcement officers' and fire fighters' retirement system plan 1 not later than June 30, 2024; and

(b) To fully fund the public employees' retirement system plans 2 and 3, the teachers' retirement system plans 2 and 3, the public safety employees' retirement system plan 2, and the school employees' retirement system plans 2 and 3 in accordance with RCW 41.45.061, 41.45.067, and this section.

(4) The aggregate actuarial cost method shall be used to calculate a combined plan 2 and 3 employer contribution rate and a Washington state patrol retirement system contribution rate.

(5) The council shall immediately notify the directors of the office of financial management and department of retirement systems of the state and employer contribution rates adopted. The rates shall be effective for the ensuing biennial period, subject to any legislative modifications.

(6) The director shall collect those rates adopted by the council. The rates established in RCW 41.45.054, or by the council, shall be subject to revision by the legislature.

[2004 c 242 § 39. Prior: 2003 c 294 § 10; 2003 c 92 § 3; 2002 c 26 § 2; prior: 2001 2nd sp.s. c 11 § 10; 2001 c 329 § 10; 2000 2nd sp.s. c 1 § 905; 2000 c 247 § 504; prior: 1998 c 341 § 404; 1998 c 340 § 11; 1998 c 283 § 6; 1995 c 239 § 309; 1993 c 519 § 19; 1992 c 239 § 2; 1990 c 18 § 1; 1989 c 273 § 6.]

NOTES:

Effective date -- 2004 c 242: See RCW 41.37.901.

Severability -- Effective date -- 2003 c 92: See RCW 41.26.905 and 41.26.906.

Effective date -- 2001 2nd sp.s. c 11: See note following RCW 41.45.030.

Effective date -- 2001 c 329: See note following RCW 43.43.120.

Severability -- Effective date -- 2000 2nd sp.s. c 1: See notes following RCW 41.05.143.

Effective dates -- Subchapter headings not law -- 2000 c 247: See RCW 41.40.931 and 41.40.932.

Effective date -- 1998 c 341: See note following RCW 41.34.060.

Effective date -- 1998 c 340: See note following RCW 41.31.010.

Intent -- Purpose -- 1995 c 239: See note following RCW 41.32.831.

Effective date -- Part and subchapter headings not law -- 1995 c 239: See notes following RCW 41.32.005.

Part headings not law -- Effective date -- 1993 c 519: See notes following RCW 28A.400.212.

Effective date -- 1992 c 239: "This act shall take effect September 1, 1992." [1992 c 239 § 6.]

Effective date -- 1990 c 18: "This act shall take effect September 1, 1991." [1990 c 18 § 3.]

Benefits not contractual right until date specified: RCW 41.34.100.

WASHINGTON STATE LEGISLATURE
Office of the State Actuary

May 25, 2004

Senator Joseph Zarelli, Chair, Ways and Means Committee
Senator Margarita Prentice, Ranking Minority Member, Ways and Means Committee
Representative Helen Sommers, Chair, Appropriations Committee
Representative Barry Sehlin, Ranking Minority Member, Appropriations Committee
Mr. John Charles, Director, Department of Retirement Systems
Mr. Marty Brown, Director, Office of Financial Management

RE: PENSION FUNDING COUNCIL

Dear Council Members:

As required under RCW 41.45.030, I am submitting information to the council regarding the experience and financial condition of each state retirement system. I am also providing advice concerning the selection of the following long-term economic assumptions:

- Annual investment return assumption (currently prescribed in statute at 8%)
- Inflation assumption (currently 3.5%)
- Growth in salaries, exclusive of merit or longevity increases (currently 4.5%)
- Growth in system membership (currently 1.25% for all systems except TRS; 0.9% for TRS)

According to RCW 41.45.030(2), by May 31, 2004, and every four years thereafter, the council may adopt changes to the long-term economic assumptions. Any changes adopted by the council are subject to revision by the legislature.

Report on Financial Condition

Not unlike other state retirement systems, and pension plans in the private-sector, Washington State retirement systems have recently experienced significant investment losses. As a result, Washington's retirement systems are not as well funded as they were just a few years ago. However, as documented in our most recent actuarial valuation report, as of September 30, 2002, Washington has $1.18 in actuarial assets for each $1 of accrued liability (credited projected liability for all systems combined).

2420 Bristol Court S.W., Suite 101
P.O. Box 40914
Olympia, WA 98504-0914
(360) 753-9144

FAX: (360) 586-8135
TDD: 1-800-635-9993
E-MAIL: actuary_st@leg.wa.gov

On an individual plan basis, TRS Plan 2/3 has the highest funding ratio with $1.82 in actuarial assets for each $1 of accrued liability. PERS Plan 1 has the lowest funding ratio with $0.92 in actuarial assets for each $1 of accrued liability.

Contrary to some retirement reports, we report Washington's funded ratios using a "smoothed" or actuarial value of assets as opposed to market value. This reporting method is in line with long-standing actuarial standards of practice and, in my opinion, provides a more appropriate measure of the plan's funded position - recognizing the long-term nature of Washington's pension plan obligations. Washington's funded ratios would be much lower if reported on a market value basis as of September 30, 2002.

Recent investment losses are not fully recognized in the current actuarial value of assets and are not projected to be completely recouped in the near future. As a result, employer and Plan 2 contributions to all Washington State Retirement Systems are projected to increase sharply over the next several biennia. The unfunded actuarial accrued liability (UAAL) under PERS Plan 1 and TRS Plan 1 is re-emerging and the surplus funded positions of the Washington State Patrol Retirement System and LEOFF Plan 1 are projected to revert to an unfunded liability.

It is important to note that an unfunded liability is not necessarily equal to insolvency. For example, as of September 30, 2002, the market value of assets in both PERS and TRS Plan 1 exceeds each plan's current annual disbursements by a factor of 10. In absence of anticipated future investment earnings and plan contributions, the market value of assets on September 30, 2002 are still sufficient to provide 10 years of current benefit payments in these two plans.

It is also important to note that projected contribution rate increases are a direct result of the systematic funding process codified under Chapter 41.45 RCW - Actuarial Funding of the State Retirement Systems. Contribution rates are automatically adjusted to fully fund the liabilities under Washington's Plan 2/3 retirement systems and state law requires that the UAAL in PERS Plan 1 and TRS Plan 1 be fully amortized by June 30, 2024. This systematic rate-setting process ensures the actuarial soundness of the funding of Washington's state retirement systems.

Report on Economic Experience

Recent economic experience data have been mixed at best. Investment markets appear to be recovering. Overall inflation remains low, but certain commodities have recently experienced significant price inflation. Recent economic indicators continue to show signs of a modest economic expansion. The current geopolitical environment, however, remains unstable and represents a threat to derail any further expansion.

Fortunately, economic assumptions for pension funding are based on a long-term measurement period. Because no one knows what the future holds with respect to economic and other contingencies, the best an actuary can do is use professional judgment to estimate possible economic outcomes based on past experience and future expectations.

During my review of the long-term economic assumptions currently prescribed in statute, I reviewed, among other items, past economic experience. This information is enclosed as separate attachments to this letter.

Recommended Economic Assumptions

According to current actuarial standards of practice, the general process for selecting economic assumptions should include the following steps:

- identify components, if any, of each assumption and evaluate relevant data;
- develop a best-estimate range for each economic assumption; and
- select a specific point estimate within the best estimate range.

For each economic assumption, the best-estimate range is the narrowest range within which the actuary reasonably anticipates that the actual results, compounded over the measurement period, are more likely than not to fall. The measurement period is the period subsequent to the valuation date during which a particular economic assumption will apply in a given measurement. As I mentioned earlier, economic assumptions for pension funding are long term. The measurement period, therefore, can easily be in excess of 30 years under this context.

After completing the above steps, the entire set of economic assumptions should be reviewed for consistency.

Inflation Assumption

The inflation assumption is a component of the investment return and general salary growth assumptions. This assumption is primarily used in the actuarial valuation to project average final compensation for retirement benefits and postretirement cost-of-living-adjustments (COLAs).

Best-Estimate Range:	2% to 5%
Recommendation:	3.5%
Current Assumption:	3.5%
Data (Attachment A):	Inflation Data
Analysis:	I reviewed the indices provided in Attachment A from 1950 to 2003. The low end of the best estimate range is based on the average of the annual change in the CPI-W, Seattle-Tacoma, Bremerton from 1950 through 1972. The high end of the best estimate range is based on the average of the annual change in the CPI-W, Seattle-Tacoma, Bremerton over the past 30 years.

Stringent monetary policy has kept inflation in check during the past two decades. The outlook of future inflation, however, is mixed given the status of the Social Security Program. Annual Social Security costs are projected to exceed tax income starting in 2018 at which time the annual gap will be covered with cash from redeeming special obligations of the Treasury. This scenario may limit the effectiveness of current monetary policy as a means of managing inflation in the future.

Growth in Salaries Assumption

As provided under current law, this assumption does not include merit or longevity increases and is used in the actuarial valuation, along with assumed merit or longevity increases, to project compensation for the calculation of projected retirement benefits and in determining normal cost contributions as a level percentage of future payroll. This general salary increase assumption, without the application of assumed merit or longevity increases, is also used in determining employer contributions to the Plan 1 UAAL as a level percentage of future system payroll.

Best-Estimate Range: N/A
Recommendation: 4.5%
Current Assumption: 4.5%

Analysis: Generally, a participant's compensation will change over the long term in accordance with inflation, productivity growth, merit or longevity increases and promotional increases. When selecting or advising on the selection of salary growth assumptions, we study total salary growth experience and divide total salary growth into the following two components:

- General salary increases (including inflation and productivity); and
- Merit or longevity increases (including promotions).

Through application of our actuarial model, therefore, assumed salary growth will come from <u>both</u> of these sources. As provided under RCW 41.45.035(1)(b), the current growth in salaries assumption is exclusive of merit or longevity increases. Any change to the general salary growth assumption that is independent from the merit or longevity increase assumptions for a specific plan will produce inconsistent economic assumptions for total salary growth. However, given that the recommended inflation assumption is unchanged from the current statutorily prescribed inflation assumption, I recommend that the general salary growth assumption remain at 4.5% (3.5% for inflation and 1% assumed productivity). To avoid future inconsistencies with the merit or longevity increase assumptions, it may be advisable for the council to review both the general salary increase assumption and merit or longevity increase assumptions when considering changes to this economic assumption in the future.

Future collective bargaining is one measurement-specific factor that may impact actual compensation experience in the future. Undoubtedly, the collective bargaining process will impact the level and pattern of future compensation changes. Not having any experience data to draw upon for affected Washington state employees, I have not included an adjustment for the future impact of collective bargaining. We will closely monitor the impact of collective bargaining as it emerges in our experience data and recommend adjustments to the council if necessary.

Growth in System Membership Assumption

This assumption is used in the amortization of Plan 1 UAAL. There is currently no UAAL for LEOFF Plan 1. The UAAL in PERS and TRS Plan 1 must be amortized by June 30, 2024 as a level percentage of projected system payroll. The projected payroll includes pay from PERS, SERS and TRS Plans 2/3 as well as projected payroll from future new members. The growth in system membership assumption is used to determine the payroll for future new members.

Best-Estimate Range: 1.75% to 2.75% for LEOFF
1% to 3% for PERS and SERS
1% to 2% for TRS

Recommendation: 0% (see analysis below)

Current Assumption: 1.25% for PERS, SERS, LEOFF
0.9% for TRS

Data (Attachment B): Growth in System Membership Data

Analysis: Amortizing the Plan 1 UAAL over plan 1 and plan 2/3 projected payroll plus the projected payroll of future new members creates a "back-loaded" amortization schedule. This method also further delays the funding of retirement benefits well past the period when the benefits were actually earned. As a result of this amortization method, dollar contributions to the Plan 1 UAAL will increase steadily as the amortization date approaches. Although the current growth in system membership assumptions are independently reasonable, I would recommend that a 0% growth assumption be utilized under the current Plan 1 amortization method.

A 0% growth assumption under the current amortization method will not completely remove the "back-loaded" nature of the current method nor will it significantly lessen the delay of funding for previously earned or accrued benefits. Rather, this recommendation is a small step in that direction.

Annual Investment Return Assumption

This assumption reflects anticipated returns on the retirement plan's current and future assets - net of expenses.

Best-Estimate Range: 7% - 9%
Recommendation: 7.75% (see analysis below)
Current Assumption: 8%

Data: Historical Plan Performance (Attachment C)
Historical Investment Data (Attachment D)
WSIB Simulated Future Returns (Attachment E)

Analysis: In addition to the items discussed in the general economic assumption selection process, there are several key factors that should be considered when selecting this assumption, namely:

- purpose of measurement (i.e., on-going plan valuation, plan termination, etc.)
- measurement period; and
- investment policy.

I have assumed that the primary purpose of the measurement is to measure the liability of the on-going retirement systems for the purpose of determining contribution requirements.

The recommended investment return assumption represents a single rate that applies to all plans invested in the commingled trust fund (CTF) and is based on the average measurement period for all plans combined. Not all plans in the CTF have equivalent measurement periods. The liabilities in the plans 1, for example, have a shorter duration (and measurement period) than the liabilities under the plans 2/3. As a result, recommended investment return assumptions on an individual plan basis could vary from the single and combined rate provided above. As the plans 1 move to 100% retired status and remain in the CTF, it may become necessary to apply separate investment return assumptions for the open and closed retirement plans in the future.

Ideally, the investment return assumption should be coordinated with the Washington State Investment Board (WSIB) current asset allocation policy or targets for the CTF. The WSIB is currently reviewing its asset allocation policy and may make changes to that policy in early 2005. My recommendation is based on the current asset allocation policy. Future changes to the CTF asset allocation policy could precipitate a new recommendation for the investment return assumption.

In determining the recommended investment return assumption of 7.75%, more weight was given to the simulated rates of future investment return provided by the WSIB than was given to historical investment and plan performance data. The current legislatively prescribed assumption of 8%, however, is within the best-estimate range and is not unreasonable.

***

I hope you find this information useful during your deliberations. Please don't hesitate to contact me directly should you require any additional information.

Sincerely,

Matthew M. Smith
State Actuary

Enclosures

O:\PFC\2004\PFC 5-25-04.wpd

Attachment A

Inflation Data

Year	Seattle-Tacoma-Bremerton, WA CPI-W	U.S. City Average CPI-W	GDP Deflator for Personal Consumption Expenditures	Annual % Change		
				Seattle CPI-W	U.S. CPI-W	GDP PCE
1950	70.3	72.1	16.675	1.4%	1.0%	1.2%
1951	75.7	77.8	17.805	7.7%	7.9%	6.8%
1952	77.6	79.5	18.169	2.5%	2.2%	2.0%
1953	78.6	80.1	18.416	1.3%	0.8%	1.4%
1954	78.6	80.5	18.585	0.0%	0.5%	0.9%
1955	79.0	80.2	18.676	0.5%	-0.4%	0.5%
1956	80.0	81.4	19.059	1.3%	1.5%	2.1%
1957	83.3	84.3	19.639	4.1%	3.6%	3.0%
1958	85.2	86.6	20.117	2.3%	2.7%	2.4%
1959	86.8	87.3	20.432	1.9%	0.8%	1.6%
1960	87.9	88.7	20.767	1.3%	1.6%	1.6%
1961	89.3	89.6	20.985	1.6%	1.0%	1.0%
1962	90.6	90.6	21.232	1.5%	1.1%	1.2%
1963	92.1	91.7	21.479	1.7%	1.2%	1.2%
1964	93.4	92.9	21.786	1.4%	1.3%	1.4%
1965	94.5	94.5	22.103	1.2%	1.7%	1.5%
1966	97.1	97.2	22.662	2.8%	2.9%	2.5%
1967	100.0	100.0	23.237	3.0%	2.9%	2.5%
1968	104.1	104.2	24.151	4.1%	4.2%	3.9%
1969	109.2	109.8	25.255	4.9%	5.4%	4.6%
1970	114.0	116.3	26.448	4.4%	5.9%	4.7%
1971	116.4	121.3	27.574	2.1%	4.3%	4.3%
1972	119.7	125.3	28.528	2.8%	3.3%	3.5%
1973	127.5	133.1	30.081	6.5%	6.2%	5.4%
1974	141.5	147.7	33.191	11.0%	11.0%	10.3%
1975	155.8	161.2	35.955	10.1%	9.1%	8.3%
1976	164.5	170.5	37.948	5.6%	5.8%	5.5%
1977	177.6	181.5	40.410	8.0%	6.5%	6.5%
1978	193.8	195.3	43.248	9.1%	7.6%	7.0%
1979	214.6	217.7	47.059	10.7%	11.5%	8.8%
1980	249.1	247.0	52.078	16.1%	13.5%	10.7%
1981	276.1	272.3	56.720	10.8%	10.2%	8.9%
1982	294.0	288.6	59.859	6.5%	6.0%	5.5%
1983	293.2	297.4	62.436	-0.3%	3.0%	4.3%
1984	302.8	307.6	64.795	3.3%	3.4%	3.8%
1985	309.1	318.5	66.936	2.1%	3.5%	3.3%
1986	311.3	323.4	68.569	0.7%	1.5%	2.4%
1987	318.6	335.0	70.947	2.3%	3.6%	3.5%
1988	329.1	348.4	73.755	3.3%	4.0%	4.0%
1989	344.5	365.2	76.972	4.7%	4.8%	4.4%
1990	369.0	384.4	80.498	7.1%	5.3%	4.6%
1991	389.4	399.9	83.419	5.5%	4.0%	3.6%
1992	403.2	411.5	85.824	3.5%	2.9%	2.9%
1993	415.2	423.1	87.804	3.0%	2.8%	2.3%
1994	430.4	433.8	89.654	3.7%	2.5%	2.1%
1995	442.9	446.1	91.577	2.9%	2.8%	2.1%
1996	457.5	459.1	93.547	3.3%	2.9%	2.2%
1997	471.7	469.3	95.124	3.1%	2.2%	1.7%
1998	484.1	475.6	95.978	2.6%	1.3%	0.9%
1999	499.1	486.2	97.575	3.1%	2.2%	1.7%
2000	517.8	503.1	100.000	3.7%	3.5%	2.5%
2001	536.2	516.8	102.039	3.6%	2.7%	2.0%
2002	545.9	523.9	103.429	1.8%	1.4%	1.4%
2003	553.6	535.6	105.325	1.4%	2.2%	1.8%
	Averages:					
	Average from 1950 - 1972			2.42%	2.49%	2.43%
	Last 30 year			5.08%	4.80%	4.30%
	Last 20 year			3.24%	2.99%	2.65%
	Last 10 year			2.92%	2.39%	1.84%

Data sources: Department of Labor, Bureau of Labor Statistics (BLS) and Department of Commerce, Bureau of Economic Analysis (BEA)

Attachment B

Growth in System Membership Data

	LEOFF		PERS		SERS		PERS + SERS		TRS	
	# of Active Members	Annual Growth	# of Active Members	Annual Growth	# of Active Members	Annual Growth	# of Active Members	Annual Growth	# of Active Members	Annual Growth
2003	15,551	2.59%	154,550	0.24%	49,214	-1.16%	203,764	-0.10%	66,075	0.02%
2002	15,158	1.73%	154,185	0.82%	49,791	2.99%	203,976	1.34%	66,063	-0.24%
2001	14,900	1.83%	152,936	0.44%	48,347	1.30%	201,283	0.65%	66,220	3.70%
2000	14,632	1.22%	152,261	-22.47% *	47,725		199,986	1.84%	63,858	1.87%
1999	14,456	4.33%	196,382	2.36%			196,382	2.36%	62,684	1.38%
1998	13,856	1.04%	191,850	2.90%			191,850	2.90%	61,828	1.67%
1997	13,714	2.19%	186,440	2.10%			186,440	2.10%	60,815	2.34%
1996	13,420	2.25%	182,603	2.11%			182,603	2.11%	59,425	0.54%
1995	13,125	3.14%	178,833	0.78%			178,833	0.78%	59,103	2.38%
1994	12,725	3.84%	177,456	1.65%			177,456	1.65%	57,731	2.05%
1993	12,255	2.30%	174,576	1.53%			174,576	1.53%	56,571	2.34%
1992	11,979	2.07%	171,947	4.21%			171,947	4.21%	55,276	4.73%
1991	11,736	4.23%	165,008	9.83%			165,008	9.83%	52,779	2.84%
1990	11,260	4.40%	150,241	7.97%			150,241	7.97%	51,323	4.34%
1989	10,785	3.17%	139,146	4.46%			139,146	4.46%	49,189	1.72%
1988	10,454	4.38%	133,210	6.07%			133,210	6.07%	48,355	2.43%
1987	10,015	3.03%	125,581	5.12%			125,581	5.12%	47,210	1.55%
1986	9,720	1.26%	119,469	2.01%			119,469	2.01%	46,489	1.76%
1985	9,599	2.40%	117,112	3.88%			117,112	3.88%	45,687	1.94%
1984	9,374	2.04%	112,740	4.60%			112,740	4.60%	44,817	3.15%
1983	9,187	2.36%	107,777	4.35%			107,777	4.35%	43,449	-2.16%
1982	8,975	0.71%	103,284	-2.68%			103,284	-2.68%	44,408	-3.87%
1981	8,912	1.12%	106,125	-4.17%			106,125	-4.17%	46,197	-0.11%
1980	8,813		110,744				110,744		46,247	
Geometric Averages:										
Total period		2.39%						2.57%		1.50%
Last 20 years		2.56%						3.00%		1.96%
Last 10 years		2.03%						1.39%		1.36%
Last 5 years		2.33%						1.21%		1.34%

* *Creation of SERS.*

Attachment C

Historical Plan Performance

Fiscal Year Ending June 30th	Investment Return
1982	2.50%
1983	47.30%
1984	-0.03%
1985	29.80%
1986	26.90%
1987	16.90%
1988	4.20%
1989	13.50%
1990	8.30%
1991	9.50%
1992	8.20%
1993	13.40%
1994	1.40%
1995	16.50%
1996	17.40%
1997	20.50%
1998	16.60%
1999	11.90%
2000	14.19%
2001	-5.96%
2002	-6.40%
2003	4.15%

Geometric Averages:

Total Period	11.70%
Last 20 Years	10.64%
Last 10 Years	8.60%

Source: Washington State Investment Board

Attachment D

Historical Investment Data

Year	Investment Return	Year	Investment Return	Year	Investment Return	Year	Investment Return
1926	8.19%	1946	-5.39%	1966	-5.11%	1986	26.90%
1927	24.03%	1947	1.87%	1967	22.62%	1987	16.90%
1928	27.35%	1948	3.57%	1968	11.63%	1988	4.20%
1929	-11.37%	1949	13.81%	1969	-10.60%	1989	13.50%
1930	-15.60%	1950	21.58%	1970	4.52%	1990	8.30%
1931	-29.72%	1951	11.15%	1971	13.87%	1991	9.50%
1932	0.43%	1952	9.83%	1972	11.88%	1992	8.20%
1933	51.03%	1953	-0.25%	1973	-11.99%	1993	13.40%
1934	7.87%	1954	36.83%	1974	-15.33%	1994	1.40%
1935	31.46%	1955	17.84%	1975	30.50%	1995	16.50%
1936	29.26%	1956	1.45%	1976	27.27%	1996	17.40%
1937	-25.42%	1957	-4.44%	1977	1.20%	1997	20.50%
1938	22.05%	1958	29.44%	1978	6.77%	1998	16.60%
1939	1.70%	1959	7.69%	1979	14.87%	1999	11.90%
1940	-3.62%	1960	3.88%	1980	20.45%	2000	14.19%
1941	-6.18%	1961	18.90%	1981	0.22%	2001	-5.96%
1942	18.00%	1962	-3.29%	1982	2.50%	2002	-6.40%
1943	27.85%	1963	15.12%	1983	47.30%	2003	4.15%
1944	19.61%	1964	13.11%	1984	-0.03%		
1945	32.02%	1965	12.87%	1985	29.80%		

Actual investment return for fiscal years ending June 30, 1982 and thereafter. Estimated investment return prior to 1982.

Geometric Averages:

Total Period	9.33%
Last 60 years	10.16%
Last 50 years	10.14%
Last 40 years	9.78%
Last 30 years	11.18%

Rolling 30-year Averages*:

Minimum	7.86%
Maximum	11.93%

** Starting in 1926. Last period ending 2003.*

Assumptions:

Asset Class	*Allocation*	*Return*
U.S. Equity	*31%*	*S&P 500*
Non-U.S. Equity	*15%*	*S&P 500*
Fixed Income	*25%*	*Average of long-term corporate and government bond index*
Private Equity	*17%*	*U.S. small cap stock index*
Real Estate	*12%*	*Average of long-term corporate and government bond index*

Constant asset allocation from 1926 through 1981.

Attachment E

WSIB Simulated Future Returns

Portfolio Statistics & Capital Market Assumptions

Asset Class	Target Allocation	Expected 1-Year Return
U.S. Equity	31%	9.0%
Non-U.S. Equity	15%	9.0%
Fixed Income	25%	5.5%
Private Equity	17%	12.0%
Real Estate	12%	8.5%
Cash	0%	3.5%
Total CTF	100%	

Simulated Future Returns

	Measurement Period	
	20 Years	**50 Years**
75th percentile	9.789%	9.012%
60th percentile	8.472%	8.184%
55th percentile	8.076%	7.934%
50th percentile	**7.688%**	**7.688%**
45th percentile	7.302%	7.444%
40th percentile	6.910%	7.195%
25th percentile	5.628%	6.381%

Source: Washington State Investment Board